No. 14-1132

Title:	Merrill Lynch, Pierce, Fenner & Smith Inc., et al., Petitioners v. Greg Manning, et al.
Docketed:	March 18, 2015
Linked with 14A1143	
Lower Ct:	United States Court of Appeals for the Third Circuit
Case Nos.:	(13-3693)
Decision Date:	November 10, 2014
Rehearing Denied:	January 15, 2015

Questions Presented

—Date—	——Proceedings and Orders----------
Mar 17 2015	Petition for a writ of certiorari filed. (Response due April 17, 2015)
Apr 16 2015	Motion for leave to file amicus brief filed by Securities Industry and Financial Markets Association.
Apr 16 2015	Waiver of right of respondents Greg Manning, et al. to respond filed.
Apr 28 2015	DISTRIBUTED for Conference of May 14, 2015.
May 1 2015	Response Requested. (Due June 1, 2015)
May 6 2015	Application (14A1143) to extend the time to file the response to the petition for a writ of certiorari from June 1, 2015 to June 16, 2015, submitted to Justice Alito.
May 7 2015	Application withdrawn.
May 8 2015	Order extending time to file response to petition to and including June 5, 2015.
Jun 5 2015	Brief of respondents Greg Manning, et al. in opposition filed.
Jun 9 2015	DISTRIBUTED for Conference of June 25, 2015.
Jun 10 2015	Reply of petitioners Merrill Lynch, Pierce, Fenner & Smith, Inc., et al. filed. (Distributed)
Jun 25 2015	DISTRIBUTED for Conference of June 29, 2015.
Jun 30 2015	Motion for leave to file amici brief filed by Securities Industry and Financial Markets Association GRANTED.
Jun 30 2015	Petition GRANTED.
Aug 4 2015	The time to file the joint appendix and petitioners' brief on the merits is extended to and including September 3, 2015.
Aug 4 2015	The time to file respondents' brief on the merits is extended to and including October 23, 2015.
Aug 18 2015	Motion to dispense with printing the joint appendix filed by petitioners Merrill Lynch, Pierce, Fenner & Smith, Inc., et al.
Aug 31 2015	Consent to the filing of amicus curiae briefs, in support of either party or of neither party, received from counsel for the respondents.
Sep 3 2015	Brief of petitioners Merrill Lynch, Pierce, Fenner & Smith, Inc., et al. filed.

Sep 3 2015	Consent to the filing of amicus curiae briefs, in support of either party or of neither party, received from counsel for the petitioners.
Sep 10 2015	Brief amicus curiae of Securities Industry and Financial Markets Association filed.
Sep 10 2015	Brief amici curiae of NASDAQ, Inc., et al. filed.
Sep 10 2015	Brief amicus curiae of Chamber of Commerce of the United States of America filed.
Sep 10 2015	Brief amici curiae of Natural Gas Supply Association, et al. filed.
Sep 10 2015	Brief amicus curiae of Interstate Natural Gas Association of America filed.
Oct 5 2015	Motion to dispense with printing the joint appendix filed by petitioner GRANTED.
Oct 9 2015	SET FOR ARGUMENT on Tuesday, December 1, 2015
Oct 19 2015	Record requested from the U.S.C.A. 3rd Circuit.
Oct 23 2015	Record received from the U.S.C.A. 3rd Circuit is electronic.
Oct 23 2015	Record received from the U.S.D.C. District of New Jersey is electronic.
Oct 23 2015	Brief of respondents Greg Manning, et al. filed.
Oct 27 2015	CIRCULATED.
Oct 30 2015	Brief amicus curiae of Public Citizen, Inc. filed. (Distributed)
Oct 30 2015	Brief amicus curiae of North American Securities Administrators Association filed. (Distributed)
Oct 30 2015	Brief amicus curiae of AARP filed. (Distributed)
Nov 23 2015	Reply of petitioners Merrill Lynch, Pierce, Fenner & Smith, Inc., et al. filed. (Distributed)
Dec 1 2015	Argued. For petitioners: Jonathan D. Hacker, Washington, D. C. For respondents: Peter K. Stris, Los Angeles, Cal.

Supreme Court, U.S.
FILED
MAR 17 2015
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14-1132

No. _____

IN THE

Supreme Court of the United States

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.; KNIGHT CAPITAL AMERICAS L.P., FORMERLY KNOWN AS KNIGHT EQUITY MARKETS L.P.; UBS SECURITIES LLC; E*TRADE CAPITAL MARKETS LLC; NATIONAL FINANCIAL SERVICES LLC; AND CITADEL DERIVATIVES GROUP LLC,
Petitioners,

v.

GREG MANNING; CLAES ARNRUP; POSILJONEN AB; POSILJONEN AS; SVEABORG HANDEL AS; FLYGEXPO AB; AND LONDRINA HOLDING LTD.,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Section 27 of the Securities Exchange Act of 1934 provides that federal courts "shall have exclusive jurisdiction" over "violations of [the Act] or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by [the Act] or the rules and regulations thereunder." 15 U.S.C. § 78aa(a).

The Fifth and Ninth Circuits have held that § 27 provides federal jurisdiction over state-law claims seeking to establish liability based on violations of the Act or its regulations or seeking to enforce duties created by the Act or its regulations. In acknowledged conflict with those decisions, the Third Circuit in this case joined the Second Circuit in holding that § 27 does not itself create federal jurisdiction over state-law claims that otherwise fall within its terms.

The question presented is:

Whether § 27 of the Securities Exchange Act of 1934 provides federal jurisdiction over state-law claims seeking to establish liability based on violations of the Act or its regulations or seeking to enforce duties created by the Act or its regulations.

PARTIES TO THE PROCEEDING

Petitioners are Merrill Lynch, Pierce, Fenner & Smith, Inc.; Knight Capital Americas L.P., formerly known as Knight Equity Markets L.P.; UBS Securities LLC; E*TRADE Capital Markets LLC; National Financial Services LLC; and Citadel Derivatives Group LLC, now known as Citadel Securities LLC, defendants below.

Respondents are Greg Manning; Claes Arnrup; Posiljonen AB; Posiljonen AS; Sveaborg Handel AS; Flygexpo AB; and Londrina Holding Ltd., plaintiffs below.

RULE 29.6 STATEMENT

Petitioner Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") is an indirect wholly owned subsidiary of Bank of America Corporation, a publicly held corporation. No publicly held company holds 10% or more of Bank of America Corporation's stock.

Petitioner Knight Capital Americas L.P. merged into an entity which became Knight Capital Americas LLC on July 1, 2012. Knight Capital Americas LLC became KCG Americas LLC ("Knight") after the market close on December 31, 2013. Knight is a subsidiary of Knight Capital Group, Inc., which is wholly owned by KCG Holdings, Inc., a publicly traded company. Jefferies Group LLC is a publicly traded company that holds 10% or more of KCG Holdings, Inc.'s stock.

Petitioner UBS Securities LLC is wholly owned by UBS AG and UBS Americas, Inc. UBS Americas,

Inc. is wholly owned by UBS AG, and UBS AG has no parent corporation. Aside from UBS AG and UBS Americas, Inc., no other publicly held company holds 10% or more of the stock of UBS Securities LLC. No publicly held company holds 10% or more of the stock of UBS AG.

Petitioner ETCM Holdings, Inc. ("ETCM") is the sole member of E*TRADE Capital Markets LLC, now known as G1 Execution Services, LLC ("G1"). ETCM owns 100% of G1. ETCM is a direct subsidiary of E*TRADE Financial Corporation, a publicly held corporation. No publicly held company holds 10% or more of G1's stock.

Petitioner National Financial Services LLC ("NFS") is an indirect, wholly owned subsidiary of FMR LLC ("FMR"), which is a privately held corporation. No publicly held corporation owns 10% or more of NFS's or FMR's stock.

Petitioner Citadel Derivatives Group LLC, n/k/a Citadel Securities LLC ("Citadel Securities") has no parent corporation, and no publicly held corporation owns 10% or more of Citadel Securities' stock.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners respectfully request a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit.

OPINIONS BELOW

The decision of the court of appeals is reported at 772 F.3d 158 and is reprinted in the Appendix to the Petition ("App.") at 1a-23a. The district court's opinion is unpublished but is reported at 2013 WL 1164838 and is reprinted at App. 24a-38a.

JURISDICTION

The court of appeals issued its decision on November 10, 2014. App. 2a. A timely petition for rehearing and rehearing en banc was denied on January 15, 2015. App. 40a. This Court's jurisdiction is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

Section 27 of the Securities Exchange Act of 1934 provides in relevant part:

> The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder.

15 U.S.C. § 78aa(a).

INTRODUCTION

The decision below exacerbates an acknowledged circuit conflict on an important and recurring question of federal securities law and federal jurisdiction.

Pursuant to the fundamental objective of the federal securities laws to establish a nationally uniform system for regulating securities transactions, § 27 of the Securities Exchange Act provides that the federal courts "shall have exclusive jurisdiction of violations" of the Act or its regulations, and "of all suits in equity and actions at law brought to enforce any liability or duty created by" the Act or its regulations. 15 U.S.C. § 78aa(a).

Consistent with the plain language and purpose of the Act, the Fifth and Ninth Circuits have held that § 27 does just what it says: it confers jurisdiction on federal courts—and only federal courts—over all actions seeking to establish liability based on violations of the Act or its regulations, or seeking to enforce duties created by the Act or its regulations. Explicitly acknowledging a direct conflict with those decisions, the Third Circuit in this case joined the Second Circuit in holding that § 27 does not create federal jurisdiction over actions within its scope. Under the rule that governs in the Second and now Third Circuits, an action otherwise within § 27's scope cannot proceed in federal court unless there is some *other*, independent basis for federal jurisdiction. On this view, § 27's sole function is to strip state courts of concurrent jurisdiction over that type of action.

That view is quite incorrect, and it is an error of exceeding importance. A central objective of the Exchange Act is to subject securities transactions to a single, nationwide system of uniform regulation. The Second and Third Circuits' interpretation of § 27 contravenes that essential objective, effectively empowering fifty-one different state-court systems to enforce the Act's standards and duties.

This case exemplifies the problem, which makes the case an ideal vehicle for resolving it. Both courts below held that respondents' claims, while framed as state-law causes of action, are based on alleged violations of, and seek to enforce duties created by, the SEC's Regulation SHO, which specifies the circumstances under which securities transactions known as "short sales" and "naked short sales" are permissible, and when they are not. The district court held that because respondents' claims were based on alleged violations of Regulation SHO, § 27 establishes federal jurisdiction and thus the case was properly removed from state court. The Third Circuit agreed with the district court that respondents' claims fall within § 27, but held that § 27 did not provide jurisdiction over them because § 27 itself *never* creates jurisdiction. As a result, the standards and duties prescribed by Regulation SHO will now be subject to interpretation by a state-court judge, enforcement by a state-court jury, and review by a state court of appeals formally bound only by state-court precedents on Regulation SHO (of which there are none, of course). That outcome could not be more at odds with the objective of § 27, and with the purpose of federal securities laws more generally.

As intolerable as that result is, it could stand uncorrected for years unless the Court grants certiorari now. On the one hand, remand orders following the Second and Third Circuits' interpretation of § 27 generally will be unappealable under 28 U.S.C. § 1447(d), while on the other hand, orders denying remand under the Fifth and Ninth Circuits' rule will be interlocutory and unappealable for that reason. This case presents a unique opportunity for review because it avoids both problems: the district court denied remand and then certified its order for interlocutory appeal. The Court will not soon see another case with proper appellate jurisdiction presenting the question of § 27's jurisdictional effect. This is the ideal case for review of that important question.

Certiorari should be granted.

STATEMENT OF THE CASE

A. Statutory And Regulatory Background

1. The Securities Exchange Act of 1934 (the "Exchange Act" or "Act") was enacted "[i]n the wake of the 1929 stock market crash and in response to reports of widespread abuses in the securities industry." *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 170 (1994). The Act "is general in scope but chiefly concerned with the regulation of post-distribution trading on the Nation's stock exchanges and securities trading markets." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 752 (1975).

Section 27 of the Exchange Act provides that federal district courts "shall have exclusive jurisdiction of violations of [the Act] or the rules and regulations

thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by [the Act] or the rules and regulations thereunder." 15 U.S.C. § 78aa(a). "Congress intended § 27 to serve at least the general purposes underlying most grants of exclusive jurisdiction: to achieve greater uniformity of construction and more effective and expert application of" the Exchange Act and the rules and regulations promulgated thereunder. *Matsushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367, 383 (1996) (internal quotation marks omitted).

2. The Exchange Act established the Securities Exchange Commission (the "SEC"), 15 U.S.C. § 78d(a), which has authority to promulgate rules and regulations under the Act. Under that authority, the SEC adopted Regulation SHO, 17 C.F.R. § 242.200 *et seq.*, which governs short sales of equity securities. *See* Short Sales, SEC Release No. 34-50103, 69 Fed. Reg. 48,008 (July 28, 2004).

"Short selling involves a sale of a security that the seller does not own or a sale which is consummated by the delivery of a security borrowed by or on behalf of the seller." "Naked" Short Selling Antifraud Rule, SEC Release No. 34-58774, 73 Fed. Reg. 61,666, 61,667 (Oct. 17, 2008). A short sale normally proceeds as follows: the short seller (1) "identifies securities she believes will drop in market price," (2) "borrows these securities from a broker," (3) "sells the borrowed securities on the open market," (4) "purchases replacement securities on the open market," and (5) "returns them to the broker—thereby closing the short seller's position." *Elec. Trading Grp., LLC v. Banc of Am. Secs. LLC*, 588

F.3d 128, 132 (2d Cir. 2009). "The short seller's profit (if any) is the difference between the market price at which she sold the borrowed securities and the market price at which she purchased the replacement securities, less [transaction costs]." *Id.* Usually, borrowed securities are delivered within three days when the sale transaction is settled. "Naked" Short Selling Antifraud Rule, 73 Fed. Reg. at 61,667 n.7.

In a "naked" short sale, by contrast, the "seller does not borrow or arrange to borrow securities in time to make delivery to the buyer within the standard three-day settlement period." *Id.* at 61,667. "As a result, the seller fails to deliver securities to the buyer when delivery is due." *Id.* This is known as a "fail" or "fail to deliver." *Id.*

While the SEC prohibits "abusive" naked short selling, neither naked short selling generally nor fails to deliver are illegal. *See* SEC Division of Market Regulation: Key Points About Regulation SHO (Apr. 11, 2005). Instead, the SEC has imposed limits on naked short sales and fails to deliver through Regulation SHO and other rules. *See* "Naked" Short Selling Antifraud Rule, 73 Fed. Reg. at 61,667.

Among other things, Regulation SHO imposes "locate" and "close out" requirements on broker-dealers in an attempt to minimize fails to deliver. *See Elec. Trading Grp.*, 588 F.3d at 135-36. The locate requirement requires a broker-dealer, before executing a short-sale order, to have "reasonable grounds to believe" that the security can be borrowed and delivered within three days. 17 C.F.R. § 242.203(b)(1)(ii). If a fail to deliver nonetheless oc-

curs and persists for thirteen days, the close-out requirement calls for broker-dealers to purchase and deliver "securities of like kind and quantity." 17 C.F.R. § 242.203(b)(3).[1] These general locate and close-out requirements are subject to certain exceptions. 17 C.F.R. § 242.203(b)(2)(i)-(iv); *id.* § 242.203(b)(3)(i)-(vii). Regulation SHO's locate requirement, for example, does not apply to short sales executed by market makers in connection with their bona fide market-making activities. *See id.* § 242.203(b)(2)(iii); SEC Division of Market Regulation: Key Points About Regulation SHO ("in certain circumstances, naked short selling contributes to market liquidity").

3. There is no New Jersey analog to Regulation SHO. *See* App. 5a, 9a. The state has not attempted to regulate short sales of securities on the national markets, and it is unlikely New Jersey could do so given the SEC's extensive regulation in this area. *See Levitin v. PaineWebber, Inc.*, 159 F.3d 698, 705-07 (2d Cir. 1998) (holding that, to the extent state-law provision could be read to regulate short sales on the national markets, it was preempted).

B. State And District Court Proceedings

1. Respondent Greg Manning, the lead plaintiff below, is the founder and former CEO of Escala Group, Inc. ("Escala"), a company traded on the NASDAQ until it was delisted in 2007. The other respondents are former Escala shareholders from

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[1] In 2008, after the alleged conduct at issue here, Regulation SHO was amended to require fails to deliver to be closed out within one day. *See* 17 C.F.R. § 242.204.

various countries around the world. *See* App. 45a-46a.

Respondents filed suit against petitioners in the Superior Court of New Jersey. App. 6a, 41a. In their amended complaint, respondents alleged that petitioners—financial institutions that clear and settle securities transactions at the nation's central clearinghouse—"engaged in the unlawful practice of naked short sales of Escala stock by creating, loaning and selling unauthorized, fictitious and counterfeit shares" and by selling or loaning stock "that they did not own, [and] never intended to borrow or locate for delivery to buyers and close-out by settling their trades." *Id.* at 43a, 51a.

Specifically, respondents alleged that petitioners' short sales were unlawful because petitioners "lack[ed] reasonable grounds to believe that the securities could be borrowed and be available for delivery." App. 44a. That allegation mirrors the language of Regulation SHO. *See* 17 C.F.R. § 242.203(b)(1) (prohibiting proprietary or customer short-sale transactions "unless the broker or dealer has . . . [r]easonable grounds to believe that the security can be borrowed so that it can be delivered on the date delivery is due"). Respondents further alleged that petitioners failed to properly "clear out" fails to deliver securities resulting from the short sales. App. 58a. That conduct, too, is addressed by Regulation SHO. *See* 17 C.F.R. § 242.203(b)(3) (requiring broker-dealers to "close out the fail to deliver position by purchasing securities of like kind and quantity" within set number of days). New Jersey

law, by contrast, does not address "locate" and "close out" requirements for short sales.

According to respondents' theory, petitioners' alleged naked short sales "increased the pool of tradable shares" of Escala stock, which, respondents say, caused their shares to decline in value. App. 44a.

Based on their naked-short-selling and counterfeit-share allegations, respondents asserted various state-law claims against petitioners: statutory claims under the New Jersey RICO Act and common-law claims for unjust enrichment, interference with economic advantage and contractual relations, breach of contract, breach of the covenant of good faith and fair dealing, and negligence. *See* App. 82a-101a.

2. Petitioners removed the suit to the United States District Court for the District of New Jersey, asserting federal jurisdiction under § 27 of the Exchange Act and 28 U.S.C. §§ 1331 and 1337. App. 9a, 26a. Respondents sought remand. *Id.* at 9a, 25a.

3. The district court denied respondents' motion to remand. App. 25a. The court began by analyzing the allegations in respondents' complaint. "Notably," the court observed, respondents "do not dispute that the alleged unlawful conduct is predicated on a violation of Regulation SHO." *Id.* at 29a. The court also noted that respondents' complaint relied on the fact that certain petitioners have been fined by the SEC and the Financial Industry Regulatory Authority ("FINRA") "for their intentional and persistent violation" of the rules and regulations governing their

"unlawful" short selling activities. *Id.* at 29a; *see id.* at 44a.

The district court therefore concluded that "the case at bar is premised upon and its resolution depends on the alleged violation of a regulation promulgated under the Act." App. 32a. And because "'Section 27 of the Exchange Act confers exclusive jurisdiction upon the federal courts for suits brought to enforce the Act or rules and regulations promulgated thereunder,'" the court held that § 27 provided federal jurisdiction. *Id.* (quoting *Matsushita Elec. Indus.*, 516 U.S. at 370).

The district court also held that 28 U.S.C. §§ 1331 and 1337 provided federal jurisdiction, applying the test set forth by this Court in *Grable & Sons Metal Products, Inc. v. Darue Engineering & Manufacturing*, 545 U.S. 308 (2005). App. 33a. In doing so, the court reiterated that respondents' claims "are predicated on [petitioners'] alleged naked short sales of Escala stock in violation of SEC Regulation SHO" and respondents would need to "show that the alleged naked short sales were illegal" to prevail on their claims. *Id.* The court further noted that respondents "d[id] not point to a New Jersey law or regulation which similarly prohibits the type of alleged conduct at issue here." *Id.* at 33a-34a.

Noting "substantial ground for difference [of opinion]" regarding the jurisdictional issues raised in this case, the district court certified an interlocutory appeal to the Third Circuit under 28 U.S.C. § 1292(b) to answer "the question of whether remand is appropriate in this case." *Manning v. Merrill*

Lynch, Pierce, Fenner & Smith, Inc., 2013 WL 2285955, at *2 (D.N.J. May 23, 2013).

C. Proceedings Before The Third Circuit

1. The Third Circuit granted respondents' petition to appeal, App. 5a, 10a, and reversed the district court's decision holding that there was federal jurisdiction over respondents' claims.

As a threshold matter, the Third Circuit agreed with the district court that respondents' claims, while nominally asserted under state law, all sought to establish a violation of or enforce a duty created by Regulation SHO. App. 8a-9a. The court emphasized that the complaint "repeatedly mentions the requirements of Regulation SHO, its background, and enforcement actions taken against some [petitioners] regarding Regulation SHO." *Id.* at 8a. The court further observed that the complaint "cites data maintained to assist broker-dealers in complying with Regulation SHO's close out requirement, and at times couches its allegations in language that appears borrowed from Regulation SHO." *Id.* at 8a-9a. The court concluded that "[t]here is no question that Plaintiffs assert in their Amended Complaint, both expressly and by implication, that Defendants repeatedly violated federal law," i.e., Regulation SHO. *Id.* at 9a.

The Third Circuit nevertheless held that § 27 did not establish jurisdiction over respondents' claims. Expressly "disagree[ing]" with decisions of the Fifth and Ninth Circuits, App. 20a & n.9, the court of appeals held that § 27 does not itself confer federal jurisdiction, but instead operates only to "divest state

courts of jurisdiction" over claims that *otherwise* raise federal questions. *Id.* at 22a.[2]

The Third Circuit's construction of § 27 rested on the court's interpretation of *Pan American Petroleum Corp. v. Superior Court of Delaware for New Castle County*, 366 U.S. 656 (1961), which, in the court's view, "all but answered" the question whether § 27 itself provides federal jurisdiction. App. 19a-20a.

In *Pan American*, this Court considered not § 27 of the Exchange Act, but § 22 of the Natural Gas Act, which contains similar exclusive-jurisdiction language. *See* App. 20a. The Third Circuit recited *Pan American*'s observation that, in § 22, "'[e]xclusive jurisdiction' is given the federal courts but it is 'exclusive' only for suits that may be brought in the federal courts. Exclusiveness is a consequence of having jurisdiction, not the generator of jurisdiction because of which state courts are excluded." *Id.* The court read that statement to mean that § 22 of the Natural Gas Act could never provide federal jurisdiction where it did not otherwise exist under § 1331 and saw "no reason" to distinguish between § 22 of the Natural Gas Act and § 27 of the Exchange Act. *Id.*

Based on that reasoning, the court of appeals "disagree[d]" with the decisions of the Fifth and

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[2] The Third Circuit separately held that respondents' complaint did not on its face "necessarily raise" a federal question under § 1331, applying the four-part test identified in *Grable*, 545 U.S. at 314. App. 12a. That question is distinct from the question whether § 27 itself creates jurisdiction over a state-law claim that asserts a violation of or seeks to enforce a duty created by Regulation SHO.

Ninth Circuits holding that "there can be jurisdiction under § 27 (and other exclusive jurisdiction provisions) even when there is not under § 1331." App. 20a; *see id.* at 20a n.9. The court instead "agree[d]" with the Second Circuit's holding "that § 27 is coextensive with § 1331 for purposes of establishing subject-matter jurisdiction." App. 22a; *see Barbara v. N.Y. Stock Exch., Inc.*, 99 F.3d 49, 55 (2d Cir. 1996). Section 27, the court concluded, "does not provide an independent basis to exercise jurisdiction" over respondents' claims. App. 22a.

2. Petitioners timely filed a petition for rehearing and rehearing en banc, which was denied. App. 40a.

REASONS FOR GRANTING THE PETITION

Certiorari should be granted to resolve a direct, acknowledged conflict between the Second and Third Circuits, on the one hand, and the Fifth and Ninth Circuits on the other, on a frequently recurring federal securities law question of great importance.

I. THE THIRD CIRCUIT'S HOLDING THAT § 27 DOES NOT PROVIDE FEDERAL JURISDICTION CONFLICTS WITH OTHER CIRCUIT DECISIONS AND IS INCONSISTENT WITH DECISIONS OF THIS COURT

A. A Direct, Acknowledged Conflict Exists Among Circuit Decisions On The Question Presented

Both the Third Circuit below and the Second Circuit have acknowledged the existence of a circuit

conflict regarding whether § 27 can provide federal jurisdiction where § 1331 does not. *See* App. 18a-19a; *NASDAQ OMX Grp., Inc. v. UBS Secs., LLC*, 770 F.3d 1010, 1030 (2d Cir. 2014).

1. The Fifth and Ninth Circuits have held that § 27 itself creates federal jurisdiction, regardless whether § 1331 separately applies.

In *Hawkins v. National Association of Securities Dealers, Inc.*, 149 F.3d 330 (5th Cir. 1998), the Fifth Circuit held that § 27 provided federal jurisdiction without conducting any analysis under § 1331. *Id.* at 331-32. The plaintiff in *Hawkins* brought state-law claims alleging that the National Association of Securities Dealers ("NASD," which is now FINRA) was biased against him, failed to properly administer an arbitration proceeding, and conspired with the defendant to deprive him of a fair arbitration. *See id.* at 330-31.

The Fifth Circuit noted that, to the extent the plaintiff's claims alleged "that the NASD breached duties it owed to [him] in its role as arbitrator, those duties arise from the NASD Code of Arbitration Procedure, which is a body of rules approved by the Securities Exchange Commission and promulgated under 15 U.S.C. § 78s." *Id.* at 331-32. Likewise, the court reasoned, to the extent the plaintiff claimed that "the NASD conspired with" or "failed to adequately supervise" the defendant, the plaintiff had "alleged violations of 15 U.S.C. §78*o*-3, the statute which allows the registration of the NASD as a self-regulating exchange, and 15 U.S.C. § 78s(g), which requires the NASD to enforce compliance with applicable securities statutes, rules, and regulations." *Id.*

at 332. The court therefore concluded that the plaintiff's claims, "though carefully articulated in terms of state law," sought "to enforce liabilities or duties created by federal securities laws which are governed exclusively by federal courts" under § 27. *Id.* As a result, there was federal jurisdiction over those claims. *See id.*

The Ninth Circuit reached the same conclusion on materially identical facts in *Sparta Surgical Corp. v. National Association of Securities Dealers, Inc.*, 159 F.3d 1209 (9th Cir. 1998). In *Sparta*, the plaintiff asserted only state-law claims, but alleged that the defendant's conduct violated NASD rules. *See id.* at 1211. The Ninth Circuit held that, because the plaintiff's complaint "sought relief based upon violation of exchange rules, subject matter jurisdiction was specifically vested in the federal district court under the Exchange Act." *Id.*

Section 27, the court correctly explained, "unequivocally 'confers exclusive jurisdiction upon the federal courts for suits brought to enforce the Act or rules and regulations promulgated thereunder.'" *Id.* at 1211-12 (quoting *Matsushita Elec. Indus.*, 516 U.S. at 370). And the plaintiff's theories, while "posited as state law claims," were "founded on the defendants' conduct in suspending trading and delisting the offering, the propriety of which must be exclusively determined by federal law." *Id.* at 1212. The plaintiff had "specifically alleged violation of exchange rules, a matter committed exclusively to federal jurisdiction," and "[w]hen a plaintiff chooses to plead what 'must be regarded as a federal claim,' then 'removal is at the defendant's option.'" *Id.* at

1213 (quoting *Caterpillar, Inc. v. Williams*, 482 U.S. 386, 399 (1987)).

The Ninth Circuit adhered to that interpretation of § 27 in *Lippitt v. Raymond James Financial Services*, 340 F.3d 1033 (9th Cir. 2003). In *Lippitt*, the court held that a state-law claim that did not seek "enforcement of any [securities] rule or regulation" fell outside the scope of § 27. *Id.* at 1037. But in reaching that conclusion, the court explained that "if [the plaintiff] were asserting a violation of an SRO rule, then . . . this would be a matter of exclusive federal jurisdiction, and therefore removal would be proper." *Id.* at 1042 (citing § 27); *see also Sacks v. Dietrich*, 663 F.3d 1065, 1068-69 (9th Cir. 2011); *Cal. ex rel. Lockyer v. Dynegy, Inc.*, 375 F.3d 831, 839-43 (9th Cir. 2004).

Numerous district court decisions outside the Fifth and Ninth Circuits have adopted the same interpretation of § 27. *See, e.g., Shimoda-Atl., Inc. v. Fin. Indus. Regulatory Auth., Inc.*, 2008 WL 2003160, at *3-4 (W.D. Ark. May 8, 2008); *Whitehall Wellington Invs., Inc. v. Nat'l Ass'n of Secs. Dealers, Inc.*, 2000 WL 1846129, at *4 & nn.4-5 (S.D. Fla. Dec. 7, 2000); *Lowe v. NASD Regulation, Inc.*, 1999 WL 1680653, at *3 (D.D.C. Dec. 14, 1999).

2. In direct, acknowledged conflict with the foregoing precedents, the Third Circuit below held that § 27 does not provide federal jurisdiction where there is not already jurisdiction under § 1331. App. 22a. Section 27, the Third Circuit said, is merely "coextensive with § 1331 for purposes of establishing subject-matter jurisdiction" and serves only to "divest state courts of jurisdiction" over cases within its

scope. *Id.* The court therefore concluded that "§ 27 does not provide an independent basis to exercise jurisdiction" over respondents' claims, *id.*, even though respondents alleged that petitioners "repeatedly violated" a federal securities regulation, *id.* at 9a.

In reaching that conclusion, the Third Circuit "agree[d]" with the Second Circuit's decision in *Barbara v. New York Stock Exchange, Inc.*, 99 F.3d 49 (2d Cir. 1996). App. 22a. In *Barbara*, the Second Circuit limited § 27's scope to claims for which federal jurisdiction would already exist under § 1331—"claims created by the [Exchange] Act or by rules promulgated thereunder." 99 F.3d at 55. The court specifically rejected the notion that § 27 also reaches "claims created by state law." *Id.*; *see also Fairfax Fin. Holdings Ltd. v. S.A.C. Capital Mgmt., LLC*, 2007 WL 1456204, at *5 (D.N.J. May 15, 2007) ("agree[ing]" with *Barbara*); *Raser Techs., Inc. v. Morgan Stanley & Co.*, 2012 U.S. Dist. LEXIS 189029, at *14 (N.D. Ga. Oct. 30, 2012) (limiting § 27's scope to suits expressly brought under the Exchange Act).[3]

3. The circuit conflict expanded by the Third Circuit's decision even goes beyond § 27. Two other statutes—the Natural Gas Act ("NGA") and the Fed-

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[3] It is not clear that the Second Circuit would follow the approach adopted in *Barbara* if it considered the issue anew today. The Second Circuit has limited *Barbara*'s application in more recent cases and has thus far avoided reconsidering the effect of § 27 by finding jurisdiction under § 1331. *See NASDAQ*, 770 F.3d at 1030; *D'Alessio v. N.Y. Stock Exch., Inc.*, 258 F.3d 93, 100-04 (2d Cir. 2001). *Barbara* therefore remains controlling in the Second Circuit.

eral Power Act ("FPA")—include "exclusive jurisdiction" provisions nearly identical to § 27, *see* 15 U.S.C. § 717u (NGA § 22); 16 U.S.C. § 825p (FPA § 317), and a nearly identical circuit conflict has arisen over the interpretation of those provisions as well.

In *Lockyer*, the Ninth Circuit applied its decision in *Sparta* construing § 27 to FPA § 317 and held that § 317 likewise confers federal jurisdiction on claims within its terms. *See Lockyer*, 375 F.3d at 839-43. And at least one district court within the Ninth Circuit has applied *Sparta* and *Lockyer* to reach the same conclusion for NGA § 22. *See Pacificorp v. Northwest Pipeline GP*, 2010 WL 3199950, at *5-6 (D. Or. June 23, 2010), *report and recommendation adopted*, 2010 WL 3219533 (D. Or. Aug. 9, 2010).

The Seventh Circuit similarly recognized in *Northeastern Rural Electric Membership Corp. v. Wabash Valley Power Associates, Inc.*, 707 F.3d 883 (7th Cir. 2013), that FPA § 317 provides an independent basis for federal jurisdiction, although the court ultimately concluded that § 317 was not satisfied on the particular facts of that case. *Id.* at 892.

In conflict with those decisions, the Sixth Circuit held in *Columbia Gas Transmission, LLC v. Singh*, 707 F.3d 583 (6th Cir. 2013), that NGA § 22 does not supply federal jurisdiction where there is not otherwise federal jurisdiction under § 1331. *Id.* at 591 (NGA § 22 "does not create the cause of action or substantial federal interest required for federal-

question jurisdiction").[4]

Viewed together with the decisions construing Exchange Act § 27, the decisions addressing FPA § 317 and NGA § 22 expand the circuit conflict from an evenly divided four circuits to an evenly divided six: the Fifth, Seventh, and Ninth Circuits all correctly recognize that the materially identical "exclusive jurisdiction" provisions of these statutes create jurisdiction even when the requirements of § 1331 are not separately satisfied, whereas the Second, Third, and Sixth Circuits all hold that the provisions do not confer jurisdiction independent of § 1331.

This case, in short, presents a broad and direct circuit conflict on the same jurisdictional issue affecting three separate federal regulatory regimes. It is difficult to imagine a more compelling basis for certiorari.

B. The Third Circuit's Holding Is Inconsistent With This Court's Precedents

The conflict over § 27 (and the similar provisions of other statutes) has arisen not *because* of any lack of clarity in this Court's own precedents, but *despite* a perfectly consistent pattern of referring to § 27 as a jurisdiction-creating statute.

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[4] The Third Circuit in this case cited the Sixth Circuit's earlier decision in *Marel v. LKS Acquisitions, Inc.*, 585 F.3d 279 (6th Cir. 2009), as consistent with the Second Circuit's holding in *Barbara*. *See* App. 18a-19a n.6. But in *Marel* the federal issue arose only "as a possible defense to a state law claim." 585 F.3d at 280. *Marel* accordingly did not answer the question of whether § 27 provides federal jurisdiction where, as here, a federal securities-law issue is presented *on the face of the complaint*. *See also infra* at 24-25.

In *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010), for example, the Court observed that the district court "had jurisdiction under 15 U.S.C. § 78aa [§ 27] to adjudicate the question whether § 10(b) applies to [the defendant's] conduct." *Id.* at 254.[5] Similarly, in *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979), the Court stated that "Section 27 grants jurisdiction to the federal courts." *Id.* at 577. And in *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964), the Court observed that § 27 "specifically grants the appropriate District Courts jurisdiction over 'all suits in equity and actions at law brought to enforce any liability or duty created' under the Act." *Id.* at 431.

The Third Circuit's decision in this case cannot be reconciled with any of those decisions. In the Third Circuit's view, § 27 does not "grant" anything to federal courts, but merely takes concurrent jurisdiction from state courts. *See* App. 22a. On that view, a federal court cannot "have jurisdiction" under § 27, but only under § 1331 or some other jurisdiction-conferring statute. The chasm between the Second and Third Circuits' construction of § 27 and this Court's longstanding, contrary understanding of the provision warrants review.

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[5] In *United States v. Yousef*, 750 F.3d 254 (2d Cir. 2014), the Second Circuit recognized that in *Morrison* "subject-matter jurisdiction was established by [§ 27], which grants district courts original jurisdiction over federal securities law claims." *Id.* at 261-62. The court did not acknowledge the tension between that observation and its earlier decision in *Barbara*.

II. THE SECOND AND THIRD CIRCUITS' VIEW THAT § 27 DOES NOT PROVIDE FEDERAL JURISDICTION IS INCORRECT

A. Section 27's Plain Language Creates Federal Jurisdiction

Section 27 states that the federal district courts "shall have exclusive jurisdiction of violations of [the Exchange Act] or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by [the Act] or the rules and regulations thereunder." 15 U.S.C. § 78aa(a).

That language encompasses the claims asserted in respondents' complaint. As the Third Circuit recognized, respondents' complaint "both expressly and by implication" alleges, as the basis for liability under state law, that petitioners "repeatedly violated federal law"—specifically, Regulation SHO, an SEC regulation promulgated under the Exchange Act. App. 9a. The court of appeals further observed that there is no state-law analog of Regulation SHO on which respondents' state-law claims could rest. *Id.* Respondents' claims thus unambiguously seek to obtain relief for a violation of Regulation SHO and to enforce the duties created by Regulation SHO. Under the plain terms of § 27, the federal courts have "exclusive jurisdiction" over those claims.

Congress frequently uses the phrase "shall have jurisdiction" to create federal jurisdiction—indeed, it is impossible to construe that phrase any other way. *Compare* 28 U.S.C. § 1291 ("The courts of appeals . . . shall have jurisdiction of appeals from all final deci-

sions of the district courts of the United States . . . except where a direct review may be had in the Supreme Court.") *with Gelboim v. Bank of Am. Corp.*, 135 S. Ct. 897, 902 (2015) ("Section 1291 gives the courts of appeals jurisdiction over appeals from 'all final decisions of the district courts of the United States.'").[6] The sole difference in § 27 is the inclusion of the modifier "exclusive" before "jurisdiction." Under the Second and Third Circuits' interpretation, the addition of the word "exclusive" somehow *undoes* the grant of federal jurisdiction achieved by the common phrase "shall have jurisdiction." That construction makes no sense at all. If anything, adding the word "exclusive" only underscores Congress's interest in ensuring federal-court supervision over claims that fall within the provision's scope—such claims not only are subject to federal jurisdiction, but they are subject *only* to federal jurisdiction.

The specific jurisdictional language reflected in § 27 is different from, and broader than, the general "arising under" language of § 1331, confirming that § 27 is *not* "coextensive with § 1331," as the Third

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[6] *See also* 7 U.S.C. § 1642(e) ("The district courts of the United States shall have jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder."); 15 U.S.C. § 378(a) ("The United States district courts shall have jurisdiction to prevent and restrain violations of this chapter and to provide other appropriate injunctive or equitable relief, including money damages, for the violations."); 33 U.S.C. § 1232(d) ("The United States district courts shall have jurisdiction to restrain violations of this chapter or of regulations issued hereunder, for cause shown.").

Circuit held. App. 22a. Section 27 broadly encompasses "*all* suits in equity and actions at law brought to enforce *any* liability or duty created by" the Exchange Act or its regulations. The question thus is not whether the claim is sufficiently federal in character to say that it "arises under" federal law, but simply whether the claim seeks to enforce an Exchange Act liability or duty. If so, the federal court "shall have . . . jurisdiction" over it, and "exclusive" jurisdiction to boot. The language of § 27 could not be clearer.

B. Construing § 27 In Accordance With Its Plain Language Also Advances Its Purposes

The Third Circuit's approach is not only irreconcilable with the statutory text, but also undermines § 27's central purpose: "'to achieve greater uniformity of construction and more effective and expert application of that law.'" *Matsushita Elec. Indus.*, 516 U.S. at 383 (quoting *Murphy v. Gallagher*, 761 F.2d 878, 885 (2d Cir. 1985)).

This case concerns short sales of securities on the national market, which are subject to comprehensive regulation under Regulation SHO. Under the guise of state-law claims, respondents accuse petitioners of engaging in naked short sales that violate Regulation SHO. Respondents are thus attempting to use state law to enforce duties imposed by the Exchange Act and regulations promulgated thereunder, and they are seeking to do so in state court, where state-court judges and juries will decide whether petitioners have violated the federal standards on which respondents' claims rely. This is exactly the type of

situation § 27 was intended to prevent. Indeed, the "danger" presented where state-court judges "who are not fully expert in federal securities law" endeavor to interpret and enforce those laws, *Matsushita Elec. Indus.*, 516 U.S. at 383, is particularly acute here, where the federal regulation at issue—Regulation SHO—is highly technical and complex.

C. The Third Circuit Misconstrued This Court's Decision In *Pan American*

The Third Circuit largely ignored § 27's language and purpose, relying instead on this Court's decision in *Pan American*, which the court deemed dispositive. *See* App. 19a-20a. *Pan American*, however, is not on point at all, much less dispositive.

Pan American involved NGA § 22, which—as discussed above, *supra* at 17-19—has the same jurisdictional language as Exchange Act § 27. But unlike here, where respondents asserted state-law claims premised on violations of Regulation SHO, the complaint in *Pan American* alleged a state-law claim for breach of contract that did *not* invoke any violation of federal law as the basis for liability. 366 U.S. at 662-64. Instead, federal issues under the NGA arose only as a *defense* to the alleged state-law breach of contract. *See id.*

The defendant objected to state-court jurisdiction on the basis of NGA § 22's "exclusive jurisdiction" language, but this Court held—applying what later became known as the "well-pleaded complaint" rule—that federal jurisdiction can arise only when the federal issue appears on "the face of the complaint," regardless of whether the "defendant is al-

most certain to raise a federal defense." *Id.* at 663. The "exclusive jurisdiction" language of NGA § 22 did not alter that long-settled rule, the Court explained: "'Exclusive jurisdiction' is given the federal courts but it is 'exclusive' only for suits that may be brought in the federal courts. Exclusiveness is a consequence of having jurisdiction, not the generator of jurisdiction because of which state courts are excluded." *Id.* at 664.

The Third Circuit misread that passage to mean that an "exclusive jurisdiction" provision does not create federal jurisdiction when the face of the complaint raises exactly the federal issue over which federal courts are to have exclusive jurisdiction—here, enforcement of a duty created by an Exchange Act regulation. *See* App. 20a. Read in context, however, the cited passage merely confirms that an "exclusive jurisdiction" provision does not overcome the long-settled well-pleaded complaint rule requiring that jurisdiction be assessed based on the claims asserted by the plaintiff on the face of the complaint. Because respondents' complaint here on its face *does* assert violations of Regulation SHO as the basis for liability, the rule applied in *Pan American* creates no barrier to federal jurisdiction in this case. The Third Circuit's contrary conclusion was incorrect.

III. THE QUESTION PRESENTED IS A RECURRING ISSUE OF NATIONAL IMPORTANCE, AND THIS CASE PRESENTS AN IDEAL VEHICLE FOR RESOLVING IT

The question presented is a recurring issue of national importance. The numerous circuit and district court decisions already cited demonstrate the fre-

quency with which the issue arises. And its significance is commensurate with the importance of the federal securities laws' core objective of subjecting securities transactions to a uniform national regulatory system.

The Third Circuit's decision, if left to stand, will seriously disrupt that system. It will encourage forum shopping by plaintiffs who would dress up alleged violations of federal securities law in state-law garb. The decision below will also permit state courts within the Third Circuit to insert themselves into the regulation of trade settlement and clearing for securities transactions executed on national exchanges. As a result, participants in the national securities markets will be required to look to the varied precedents of the states to determine what rules and standards may apply to their trading activities. The decision below will thus generate substantial uncertainty and confusion for market participants—the opposite of what Congress intended.

Further, as discussed above, the jurisdictional issue here is not limited to § 27, but applies equally to the NGA and the FPA. Like the Exchange Act and securities regulation, those laws reflect a judgment by Congress that the interstate allocation and transportation of energy requires a nationally uniform regulatory system—an objective thwarted when federal regulatory standards and duties become enforceable in state courts through state-law vehicles.

Finally, this case presents an ideal vehicle for resolving the jurisdictional controversy and restoring the uniformity Congress intended in the Exchange Act and other statutes. The Third Circuit below rec-

ognized that there is "no question" that respondents' complaint alleged that petitioners "repeatedly violated" Regulation SHO. App. 9a. The question whether § 27 provides federal jurisdiction is thus clearly and cleanly presented here. If this Court were to disagree with the Third Circuit and hold that § 27 does provide federal jurisdiction, the Third Circuit's recognition that respondents have alleged violations of federal securities regulations would necessarily lead to the conclusion that there is federal jurisdiction over respondents' claims. It was only by holding that § 27 requires a separate, independent basis for federal jurisdiction that the Third Circuit was able to deny federal jurisdiction in this case.

If the Court declines to address the question presented in this case, the circuit conflict is likely to fester for years without presenting another opportunity for this Court to intervene and establish a uniform federal rule. Application of the Third Circuit's reading of § 27 will result in remand of cases raising federal securities-law issues as a predicate for state-law liability, and there is ordinarily no appellate review of a remand order based on a lack of jurisdiction. 28 U.S.C. § 1447(d) ("An order remanding a case to the State court from which it was removed is not reviewable on appeal or otherwise."); *see Kircher v. Putnam Funds Trust*, 547 U.S. 633, 648 (2006) (holding that § 1447(d) bars appellate review of remand orders in cases removed under SLUSA). It will thus be difficult to obtain review of future decisions applying the Third Circuit's holding in this case. Now is the time, and this is the case, to determine conclusively whether § 27 means what it says.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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March 17, 2015

APPENDIX

APPENDIX A

COURT OF APPEALS OPINION

PRECEDENTIAL

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 13-3693

GREG MANNING; CLAES ARNRUP; POSILJONEN AB; POSILJONEN AS; SVEABORG HANDEL AS; FLYGEXPO AB; LONDRINA HOLDING LIMITED,
Appellants

v.

MERRILL LYNCH PIERCE FENNER & SMITH, INC.; KNIGHT CAPITAL AMERICAS, a/k/a Knight Equity Markets L.P.; UBS SECURITIES LLC; E TRADE CAPITAL MARKETS LLC; NATIONAL FINANCIAL SERVICES LLC; CITADEL DERIVATIVES GROUP LLC; JOHN DOES 1-10 (names being fictitious); ABC COMPANIES (names being fictitious), jointly, severally or in the alternative, individually

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On Appeal from the United States District Court
for the District of New Jersey
District Court No. 2-12-cv-04466
District Judge: The Honorable Jose L. Linares

Submitted Pursuant to Third Circuit L.A.R. 34.1(a)
July 10, 2014

Before: SMITH, VANASKIE, and SLOVITER,
Circuit Judges

(Filed: November 10, 2014)

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OPINION

SMITH, *Circuit Judge.*

After the District Court denied Plaintiffs' motion to remand this case to New Jersey state court, we granted their petition for an interlocutory appeal. The issue before us is whether there is federal-question jurisdiction over Plaintiffs' state-law claims, which allege that defendants manipulated the price of a stock via abusive "naked" short sales. Short sales are subject to detailed federal regulation under Regulation SHO. New Jersey does not have an analogous provision. However, the question of whether the naked short selling at issue in this case violates New Jersey law (including the state's general securities fraud provisions) need not be answered by reference to Regulation SHO. Because the success of Plaintiffs' state-law causes of action does not "necessarily" depend upon the contents of federal law, this case does not "arise under" the laws of the United States. The presence of an exclusive jurisdiction provision governing Regulation SHO

does not change the analysis, as such provisions cannot independently generate jurisdiction.

We hold that there is no federal-question jurisdiction over this suit. Accordingly, we will reverse the order denying remand, and direct the District Court to remand this case to the Superior Court of New Jersey.

I.

Plaintiffs are shareholders in Escala Group, Inc. ("Escala"). Named Defendants are financial institutions that engage in equity trading. Plaintiffs filed this lawsuit in the Superior Court of New Jersey alleging that Defendants participated in "naked" short selling of Escala stock, which "increased the pool of tradable shares by electronically manufacturing fictitious and unauthorized phantom shares." (Am. Compl. ¶ 4.) Plaintiffs also refer to these shares as "counterfeit." (Am. Compl. ¶ 37.) Plaintiffs claim that this alleged increase in Escala shares diluted their voting rights and caused their shares to decline in value. The Amended Complaint pleads ten causes of action, with all claims asserted under New Jersey law. These causes of action address: (i) claims under the New Jersey Racketeer Influenced and Corrupt Organizations ("RICO") Act based on predicate acts of New Jersey securities fraud and theft; and (ii) common law claims for unjust enrichment, interference with economic advantage and contractual relations, breach of contract, breach of the covenant of good faith and fair dealing, and negligence.

A normal (i.e., non-naked) short sale is usually accomplished in six steps: (1) "[t]he short seller identifies securities she believes will drop in market price;" (2) arranges to "borrow[] these securities from a broker;" (3) "sells the borrowed securities on the open market;" (4) waits some period of time hoping the securities decline in value; (5) "purchases replacement securities on the open market;" and (6) "returns them to the broker—thereby closing the short seller's position." *Elec. Trading Grp., LLC v. Banc of Am. Sec. LLC*, 588 F.3d 128, 132 (2d Cir. 2009). "The short seller's profit (if any) is the difference between the market price at which she sold the borrowed securities and the market price at which she purchased the replacement securities, less [transaction costs]." *Id.* Usually a buyer takes delivery of the borrowed securities within three days following the purchase. Amendments to Regulation SHO, SEC Release No. 34-58773, 73 Fed Reg. 61706, 61707 n.8 (Oct. 14, 2008).

However, "[i]n a 'naked' short sale . . . the short seller does not borrow securities in time to make delivery to the buyer within the standard three-day settlement period. As a result, the seller fails to deliver securities to the buyer when delivery is due (known as a 'fail' or 'fail to deliver'). Sellers sometimes intentionally fail to deliver securities as part of a scheme to manipulate the price of a security, or possibly to avoid borrowing costs associated with short sales, especially when the costs of borrowing stock are high." *Id.* at 707-08. Naked short selling is not per se illegal under federal law. However, some naked short selling

schemes may run afoul of federal antifraud laws, as well as Regulation SHO. 'Naked' Short Selling Antifraud Rule, SEC Release No. 34-58774, 73 Fed. Reg. 61666, 61667 (Oct. 14, 2008).

Regulation SHO, 17 C.F.R. § 242.200 *et seq.*, was adopted in 2004 by the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to its authority under the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78a *et seq.* *See* Short Sales, SEC Release No. 34-50103, 69 Fed. Reg. 48008 (July 28, 2004). Among other restrictions, Regulation SHO imposes "locate" and "close out" requirements on broker-dealers in an attempt to minimize fails to deliver. Under the locate requirement, before executing a short sale order, a broker-dealer must have "reasonable grounds" to believe that the security can be borrowed and delivered within three days. 17 C.F.R. § 242.203(b)(1). If a fail to deliver has occurred and persists for thirteen days, under the "close out" requirement broker-dealers may be required to purchase and deliver securities "of like kind and quantity." 17 C.F.R. § 242.203(b)(3); *Elec. Trading Grp.*, 588 F.3d at 135-36.

Although Plaintiffs' causes of action are all brought under state law, the Amended Complaint repeatedly mentions the requirements of Regulation SHO, its background, and enforcement actions taken against some Defendants regarding Regulation SHO. It also cites data maintained to assist broker-dealers in complying with Regulation SHO's close out requirement, and at times couches its allegations in language that appears borrowed

from Regulation SHO. Further, plaintiffs plead that "Defendants violated the trading rules and regulations requiring that they actually deliver shares . . . to settle short sale transactions." (Am. Compl. ¶ 33.) There is no question that Plaintiffs assert in their Amended Complaint, both expressly and by implication, that Defendants repeatedly violated federal law. Moreover, there is no New Jersey analogue to Regulation SHO.

Defendants removed the suit from the Superior Court of New Jersey to the United States District Court for the District of New Jersey, premised on the existence of federal-question jurisdiction. Plaintiffs sought remand. On December 31, 2012, the Magistrate Judge issued a Report and Recommendation suggesting that Plaintiffs' motion to remand be granted: "because [Plaintiffs] may succeed on their New Jersey RICO claims . . . and state common law claims . . . without establishing liability under federal law, the Amended Complaint, on its face, does not raise necessarily a substantial issue of federal law." *Manning v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 12–4466, 2012 WL 7783142, at *4 (D.N.J. Dec. 31, 2012). The District Court disagreed in a March 20, 2013 opinion: "the case at bar is premised upon and its resolution depends on the alleged violation of a regulation promulgated under the [Exchange] Act." *Manning v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, No. 12–4466, 2013 WL 1164838, at *4 (D.N.J. Mar. 20, 2013).

Noting "substantial ground for difference [of opinion] here, as evinced by the different outcome

reached by this Court and [the] Magistrate Judge . . . in this case," on May 23, 2013, the District Court certified an interlocutory appeal to this Court, pursuant to 28 U.S.C. § 1292(b), to answer "the question of whether remand is appropriate in this case." *Manning v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, No. 12–4466, 2013 WL 2285955, at *2 (D.N.J. May 23, 2013). On August 28, 2013, we granted Plaintiffs' petition to appeal.

II.

Defendants removed this suit to federal court pursuant to 28 U.S.C. § 1441, asserting federal jurisdiction under 28 U.S.C. §§ 1331 and 1337 and 15 U.S.C. § 78aa. We have jurisdiction over this interlocutory appeal pursuant to 28 U.S.C. § 1292(b).

"We exercise plenary review over [a] district court's order denying [a] motion for remand." *Werwinski v. Ford Motor Co.*, 286 F.3d 661, 665 (3d Cir. 2002).

III.

The sole issue on appeal is whether there is federal-question jurisdiction over Plaintiffs' claims. "The removing party . . . carries a heavy burden of showing that at all stages of the litigation the case is properly before the federal court. Removal statutes are to be strictly construed, with all doubts to be resolved in favor of remand." *Brown v. Jevic*, 575 F.3d 322, 326 (3d Cir. 2009) (internal citations omitted). Defendants point to two principal statutory provisions they believe confer

jurisdiction here: 28 U.S.C. § 1331 and 15 U.S.C. § 78aa ("§ 27" of the Exchange Act).[1] Section 1331, the "general federal-question statute," *Michigan v. Bay Mills Indian Cmty.*, 134 S. Ct. 2024, 2030 n.2 (2014), gives district courts original jurisdiction over "all civil actions arising under the Constitution, laws, or treaties of the United States." Section 27 gives district courts "exclusive jurisdiction . . . of all suits in equity and actions at law brought to enforce any liability or duty created by [the Exchange Act] or the rules and regulations thereunder."

A.

Section 1331 "is invoked by and large by plaintiffs pleading a cause of action created by federal law." *Grable & Sons Metal Prods., Inc. v. Darue Eng'g & Mfg.*, 545 U.S. 308, 312 (2005); *see also Gunn v. Minton*, 133 S. Ct. 1059, 1064 (2013) ("Most directly, a case arises under federal law when federal law creates the cause of action asserted.") (citing *Am. Well Works Co. v. Layne & Bowler Co.*, 241 U.S. 257, 260 (1916)). However, causes of action under state law may nonetheless "arise under" federal law for purposes of § 1331 if the four-pronged *Grable* test is met. "[F]ederal jurisdiction over a state law claim will lie if a federal issue is: (1) necessarily raised, (2) actually disputed, (3) substantial, and (4) capable of resolution in federal court without disrupting the federal-state balance approved by Congress."

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[1] 28 U.S.C. § 1441(a) authorizes removal of "any civil action" over which district courts "have original jurisdiction."

Gunn, 133 S. Ct. at 1065 (applying *Grable*). Only a "slim category" of cases satisfy the *Grable* test. *Empire Healthchoice Assurance, Inc. v. McVeigh*, 547 U.S. 677, 701 (2006). Because we conclude that no federal issue has been necessarily raised here, we need not decide whether the other three *Grable* requirements are met.

For a federal issue to be necessarily raised, "vindication of a right under state law [must] necessarily turn[] on some construction of federal law." *Franchise Tax Bd. of State of Cal. v. Constr. Laborers Vacation Trust for S. Cal.*, 463 U.S. 1, 9 (1983). *Grable* presented one of the rare instances where a federal issue was necessarily raised. Grable sued under state law to quiet title. Five years prior to the suit, the Internal Revenue Service ("IRS") seized Grable's land to satisfy a tax deficiency. The IRS then sold that land to the defendant. Grable argued that the IRS did so without giving sufficient notice as required by federal law. Because "whether Grable was given notice within the meaning of the federal statute is . . . an *essential element* of its quiet title claim," the Supreme Court held that the issue of what notice was required under federal law was necessarily raised. *Grable*, 545 U.S. at 315 (emphasis added).

The "classic example," *id.* at 312, of this type of arising under jurisdiction similarly required a determination of federal law as an essential element of the plaintiff's state law claim. In *Smith v. Kansas City Title & Trust Co.*, 255 U.S. 180 (1921), plaintiff sued under a state law which forbade the defendant from investing in illegal

securities. The alleged source of illegality was that the federal bonds purchased by the defendant were unconstitutional (on the theory that Congress did not have the power to issue them). Because the "decision depend[ed] upon the determination of [the constitutional] issue," "which [was] directly drawn in question," federal jurisdiction was proper. *Id.* at 245-46.

By contrast, Regulation SHO is not an element of any of Plaintiffs' claims. The claims, therefore, could be decided without reference to federal law. Plaintiffs alleged a market manipulation scheme and sued exclusively under New Jersey law, including its common law. The District Court, "noting that Plaintiffs do not point to a New Jersey law or regulation which similarly prohibits the type of alleged conduct at issue here," found that the claims were necessarily predicated on the violation of Regulation SHO. *Manning*, 2013 WL 1164838, at *5. We conclude it was improper for the District Court to foreclose the possibility that particular state causes of action could permit recovery solely under state law. It is true that New Jersey's laws are not as robust as federal laws. But we have previously held that even where "[t]here may be some basis to agree with defendants that [plaintiffs'] view of the state law is incorrect and will be so found[, i]t is . . . for the state court to make the determination as to the applicability of its state law." *United Jersey Banks v. Parell*, 783 F.2d 360, 367 (3d Cir. 1986).

Indeed, even under federal law, a claim based on "abusive 'naked' short selling as part of a

manipulative scheme," can be maintained without a predicate violation of Regulation SHO, because such schemes are "always illegal under the general antifraud provisions of the federal securities laws . . . ." 'Naked' Short Selling Antifraud Rule, 73 Fed. Reg. at 61667. Such manipulative schemes may "drive down a company's stock price" and "undermine the confidence of investors," which may, in turn, make investors more "reluctant to commit capital." *Id.* at 61670. If naked short selling can result in a violation of federal general antifraud provisions independently of Regulation SHO, it is difficult to imagine why naked short selling cannot similarly result in a violation of state general antifraud provisions independently of Regulation SHO. Moreover, the Supreme Court of New Jersey, exercising its common-law authority over New Jersey's general securities fraud provisions, has not shied away from deviating from federal law. *See Kaufman v. i-Stat Corp.*, 165 N.J. 94, 97 (2000) ("Even though the theory of fraud on the market has a place in the securities law of this nation, it is a stranger to New Jersey's securities laws. It is also not consistent with the current requirements for a common-law action for fraud in New Jersey.").

As we read the Amended Complaint, no causes of action are predicated *at all* on a violation of Regulation SHO. *Cf. Lippitt v. Raymond James Fin. Servs., Inc.*, 340 F.3d 1033, 1037 (9th Cir. 2003), *as amended* (Sept. 22, 2003) (no jurisdiction even where the complaint "unnecessarily describes the alleged conduct of the defendants in terms that track almost verbatim the misdeeds proscribed by

[federal law]"). For example, Plaintiffs do not plead a violation of Regulation SHO as a predicate violation for purposes of New Jersey RICO. Nor, for the reasons above, do we think Plaintiffs' causes of action necessarily need to be predicated on a violation of Regulation SHO for Plaintiffs to have a chance at recovering under state law.

But even if Plaintiffs' claims were *partially* predicated on federal law, federal law would still not be necessarily raised. *See Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 810 (1988) ("[A] claim supported by alternative theories in the complaint may not form the basis for [federal] jurisdiction unless [federal] law is essential to each.").[2] Where "[p]laintiffs' state [law] RICO claims allege both federal and state predicate acts," no federal question is necessarily raised because a Plaintiff could "prevail upon their New Jersey RICO claims or any of their other state-law claims without any need to prove or establish a violation of federal law." *Fairfax Fin. Holdings Ltd. v. S.A.C. Capital Mgmt., LLC*, No. 06-4197, 2007 WL 1456204, at *2-3 (D.N.J. May 15, 2007) (applying *Christianson* to RICO claims premised on manipulative short selling).

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[2] Although *Christianson* concerned 28 U.S.C. § 1338 (dealing with actions "arising under" the patent laws) rather than § 1331, the Supreme Court noted the "identical language" in the two provisions and applied the "same test" to both. 486 U.S. at 808. *See also Gunn*, 133 S. Ct. at 1064-65 (citing *Christianson* and applying the *Grable* § 1331 analysis to § 1338).

Defendants also assert jurisdiction under § 1331 on the basis of a Frequently Asked Questions ("FAQ") page on the SEC's website. The website is clear from the outset that the FAQ responses are "not rules, regulations, or statements of the [SEC]," nor has the Commission approved them.[3] This website, which we are told refutes Plaintiffs' theory of damages, says that naked short selling does not create "counterfeit shares"—a term Plaintiffs employ liberally in the Amended Complaint. But the phrase "counterfeit shares" does not appear a single time anywhere in the United States Code or the Code of Federal Regulations. Defendants simply cannot carry their burden of establishing jurisdiction based on a "disputed issue of federal . . . law," *Grable*, 545 U.S. at 310, without identifying a particular source of federal law for the judiciary to interpret.

Even if Plaintiffs' theories are factually contradicted by actual rules with the force of law, as the Eighth Circuit thought similar theories were in *Pet Quarters, Inc. v. Depository Trust & Clearing Corp.*, 559 F.3d 772, 781 (8th Cir. 2009) (referencing National Securities Clearance Corporation rules), Defendants would at best be entitled to a preemption defense. "Federal preemption is ordinarily a federal defense to the plaintiff's suit. As a defense, it does not appear on

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[3] Division of Market Regulation: Responses to Frequently Asked Questions Concerning Regulation SHO, http://www.sec.gov/divisions/marketreg/mrfaqregsho1204.htm (last visited October 24, 2014).

the face of a well-pleaded complaint, and, therefore, does not authorize removal to federal court." *Metro. Life Ins. Co. v. Taylor*, 481 U.S. 58, 63, (1987).[4]

Defendants do not purport to cite a single case regarding § 1331 (other than *Grable* and *Gunn*) in support of their contention that a question of federal law is necessarily raised here. Nonetheless, defendants do cite *D'Alessio v. New York Stock Exchange, Inc.*, 258 F.3d 93, 101-102 (2d Cir. 2001),[5] which held that there was jurisdiction under § 1331 where a court was

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[4] The Eighth Circuit in *Pet Quarters* held that state law claims against SEC-registered clearing agencies for maintaining a program under rules approved by the SEC (which allowed some naked short selling to occur) were all conflict preempted. Although ostensibly recognizing the rule that preemption does not usually give rise to federal-question jurisdiction, the Eighth Circuit held that the *Grable* test was satisfied as the complaint "presents a substantial federal question because it directly implicates actions taken by the Commission . . . ." 559 F.3d at 779. Although Defendants argue that the identity of the defendant is not relevant to the *Grable* inquiry, were we to expand the Eighth Circuit's holding in *Pet Quarters* to all private defendants anytime a plaintiff's claim was uncomfortably juxtaposed with federal regulations, preemption-like arguments would always create federal-question jurisdiction.

[5] Defendants contend *D'Alessio* supports jurisdiction under § 27. But it was plainly decided under § 1331, *id.* at 101, and § 27 was only mentioned in the context of what is now prong three of *Grable* (substantiality) after the necessarily raised issue was resolved. 258 F.3d at 104.

"require[d] . . . to construe federal securities laws," because the plaintiff alleged that the New York Stock Exchange "failed to perform its statutory duty, *created under federal law*, to enforce its members' compliance with those laws." The instant case is distinguishable as Plaintiffs' claims could rise or fall entirely based on the construction of state law.

We conclude that § 1331 does not provide a basis to exercise jurisdiction over Plaintiffs' claims.

B.

Having concluded that there is no arising under jurisdiction here pursuant to § 1331, we must decide whether the exclusive jurisdiction provision in § 27 of the Exchange Act might nonetheless provide a more expansive basis for federal-question jurisdiction. Although Defendants, in advancing this argument, contend that "every circuit court has reached the same conclusion," Appellees' Br. 2, the issue has actually split the two circuits that have most directly addressed it. *Compare Barbara v. N. Y. Stock Exch., Inc.*, 99 F.3d 49, 55 (2d Cir. 1996) ("Our determination that [plaintiff]'s state court complaint did not 'arise under' federal law within the meaning of section 1331 effectively resolves our inquiry under section 27 of the Exchange Act as well. . . . We think that [section 27] plainly refers to claims created by the Act or by rules promulgated thereunder, but not to claims created by state law.")[6] *with Cal. ex rel. Lockyer v.*

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[6] *See also Marel v. LKS Acquisitions, Inc.*, 585 F.3d 279, 280-81 (6th Cir. 2009) ("As the controversy in this case . . .

Dynegy, Inc., 375 F.3d 831, 841 (9th Cir. 2004)[7] ("*Sparta* [*Surgical Corp. v. National Association of Securities Dealers*, 159 F.3d 1209 (9th Cir. 1998)] establishes, however, that the exclusive jurisdiction provision takes the case outside of the rule . . . which otherwise might bar the action if the only jurisdictional provision implicated were [section] 1331. . . . [In *Sparta*] there would have been no jurisdiction predicated solely on [section] 1331. Yet the claim lay 'not under [section] 1331, but under [section 27].'") (internal citations omitted). The Second Circuit recently acknowledged this split in *NASDAQ OMX Grp., Inc. v. UBS Sec., LLC*, No. 13-2657, 2014 WL 5486457, at *17 (2d Cir. Oct. 31, 2014).[8]

We believe the Supreme Court all but answered this question in *Pan American Petroleum Corp. v.*

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was one to enforce a state law claim, this grant of exclusive jurisdiction [in § 27] does not apply. *See Barbara*.").

[7] *Opinion amended on other grounds on denial of rehearing*, 387 F.3d 966 (9th Cir. 2004).

[8] In an "odd[] . . . discuss[ion]," *id.* at *33 (Straub, J. dissenting), on substantially different facts than at issue here, the Second Circuit considered *Sparta* and similar decisions relevant to its analysis of the fourth prong of *Grable* (whether exercising jurisdiction under § 1331 would upset the federal-state balance of judicial responsibilities). Specifically, that court declared that exercising jurisdiction under § 1331 would not upset the federal-state balance given that jurisdiction could be exercised in other circuits under § 27, even though it acknowledged that its own decision in *Barbara* "declined to adopt such a broad reading of [§ 27]"—a decision it was not revisiting. *Id.* at *17.

Superior Court of Delaware In & For New Castle County, 366 U.S. 656 (1961). There, the Supreme Court considered an exclusive jurisdiction provision substantially identical to § 27 of the Exchange Act: § 22 of the Natural Gas Act. *Cf. Tafflin v. Levitt*, 493 U.S. 455, 471 (1990) (noting similarities in the specific language used in § 22 of the Natural Gas Act and § 27 of the Exchange Act, in contrast to other "governing statutes" "[i]n the standard fields of exclusive federal jurisdiction"). "[In § 22 of the Natural Gas Act, 'e]xclusive jurisdiction' is given the federal courts but it is 'exclusive' only for suits that may be brought in the federal courts. Exclusiveness is a consequence of having jurisdiction, not the generator of jurisdiction because of which state courts are excluded." *Pan Am.*, 366 U.S at 664. We see no reason to treat the two provisions differently.

Accordingly, we disagree with the line of Ninth Circuit cases which have held that there can be jurisdiction under § 27 (and other exclusive jurisdiction provisions) even when there is not under § 1331.[9] We note that the Ninth Circuit in its seminal decision in *Sparta* did not consider the Supreme Court's holding in *Pan American*. The incongruity between *Sparta* and *Pan American* was brought squarely before the Ninth Circuit in *Dynegy*.

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[9] *Hawkins v. National Ass'n of Securities Dealers Inc.*, 149 F.3d 330, 331-32 (5th Cir. 1998) (per curiam), although not as explicit as *Sparta* and *Dynegy*, could be read as holding that § 27 can provide subject-matter jurisdiction independently of § 1331. To the extent *Hawkins* so holds, we disagree with it.

At issue in *Dynegy* was the import of § 317 of the Federal Power Act—an exclusive jurisdiction provision substantially identical to both § 27 (which was at issue in *Sparta*) and § 22 (which was at issue in *Pan American*). Although the Ninth Circuit, in a footnote, acknowledged that *Pan American* made clear that such provisions were not "'generator[s] of jurisdiction,'" it nonetheless "fe[lt] bound . . . by *Sparta*'s subsequent interpretation."[10] *Dynegy*, 375 F.3d at 843, n.10. We are not confronted with such a problem, as this Court has faithfully applied *Pan American* to other exclusive jurisdiction provisions. *See Exxon Corp. v. Hunt*, 683 F.2d 69, 74 (3d Cir. 1982) (applying *Pan American* to § 113(b) of the Comprehensive Environmental Response, Compensation and Liability Act).

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[10] Although the Ninth Circuit acknowledged in that footnote that the Supreme Court's holding in *Pan American* actually meant something relevant, the text of its opinion belies that admission: "The *Pan American* court's holding is unremarkable insofar as it held that cases falling *outside* the scope of the exclusive jurisdiction provision are not subject to it." *Dynegy*, 375 F.3d 831 at 843. In reality, *Pan American* stands for the proposition that cases otherwise falling outside the scope of the district courts' *original jurisdiction* are not brought within it by virtue of an exclusive jurisdiction provision. *See In re W. States Wholesale Natural Gas Antitrust Litig.*, 346 F. Supp. 2d 1123, 1130 (D. Nev. 2004). Such is the doctrinal disarray created by *Dynegy* and *Sparta*, that a district court "reluctant[ly] . . . conclu[ded]" that it could not follow the Supreme Court's holding in *Pan American* even with respect to § 22 of the Natural Gas Act—the very provision at issue in *Pan American*. *See Pacificorp v. Nw. Pipeline GP*, No. 10–99, 2010 WL 3199950, at *6 n.3 (D. Or. June 23, 2010) *report and recommendation adopted*, 2010 WL 3219533 (Aug. 9, 2010).

Although it does not appear that any court has expressly relied on *Pan American* to hold that § 27 does not authorize a departure from the *Grable* line of cases, courts have cited *Pan American* in holding that § 27 does not depart from § 1331 in other ways. *See Calvert Fire Ins. Co. v. Am. Mut. Reinsurance Co.*, 600 F.2d 1228, 1231 (7th Cir. 1979) (§ 27 does not prevent state courts from hearing Exchange Act defenses); *Gold v. Blinder, Robinson & Co.*, 580 F. Supp. 50, 54 (S.D.N.Y. 1984) (§ 27 "does not bar a plaintiff from pursuing at its option cognate remedies based entirely upon state law"); *McMahon Chevrolet, Inc. v. Davis*, 392 F. Supp. 322, 324-25 (S.D. Tex. 1975) ("This Court is of the opinion that the exclusive jurisdiction of the federal courts under [§ 27] is like the exclusive jurisdiction of the federal courts under . . . the Natural Gas Act . . . in that such jurisdiction does not bar a plaintiff from pursuing at his option remedies based solely on state law. *Pan Am.*").

We agree with the Second Circuit's holding in *Barbara* that § 27 is coextensive with § 1331 for purposes of establishing subject-matter jurisdiction—the exclusive jurisdiction provision merely serves to divest state courts of jurisdiction.[11] Accordingly, § 27 does not provide an independent basis to exercise jurisdiction over Plaintiffs' claims.

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[11] The District of New Jersey already reached this conclusion in a prior short selling case by relying on *Barbara*. *Fairfax*, 2007 WL 1456204, at *5.

IV.

Having concluded that federal-question jurisdiction is lacking, we will reverse the District Court's March 20, 2013 order, and remand with instructions that the District Court remand this case to the Superior Court of New Jersey.

APPENDIX B

DISTRICT COURT OPINION

NOT FOR PUBLICATION

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

GREG MANNING, et al., Plaintiffs, v. MERRILL LYNCH, PIERCE, FENNER & SMITH, INC. et al., Defendants.	Civil Action No.: 12-4466 (JLL) **OPINION**

This matter comes before the Court by way of the December 31, 2012 Report and Recommendation by the Magistrate Judge Michael Hammer and the objections submitted thereto by Defendants Merrill Lynch, Pierce, Fenner & Smith, Inc., Knight Capital Americas, L.P., UBS Securities, L.L.C., E*TRADE Capital Marks, L.L.C., National Financial Services, L.L.C. (collectively "Defendants" or "Merrill Lynch").

Upon consideration of the objections submitted by Defendants, the Court ordered Plaintiffs to submit a response, which they did on March 4, 2013 (CM/ECF No. 44). On March 8, 2013, Defendants filed a letter in response to Plaintiffs' submission. (CM/ECF No. 45).[1] For the reasons set forth below, upon *de novo* consideration of the issues objected to by Defendants, the Court DENIES Plaintiffs' motion to remand this matter to the Superior Court of New Jersey.

Plaintiffs allege that Defendants engaged in illegal and manipulative "naked short selling" of Escala Group, Inc. ("Escala Group"), of which they own shares. "'Short selling' is the practice of borrowing shares of stock, selling them and seeking to repurchase those shares at a lower price, returning the lower-priced shares to the lender and keeping the difference as profit." *Fairfax Financial Holdings, Ltd. v. S.A.C. Capital Management, LLC*, Civ. No. 06–4197, 2007 WL 1456204, at *1 (D.N.J. May 15, 2007) (Cavanaugh, J.). The parties do not dispute that "short selling" is a legal practice. As explained by Judge Hammer, however, "'naked short-selling' occurs when traders sell shares they do not own or borrow, or ever intend to own, and never deliver the 'borrowed' securities that they sell.'" (Report and Recommendation, 2–3) (citing *Avenius v. Banc of Am. Sec. LLC*, Civ. No. 06-4458, 2006 WL

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[1] Defendants filed the March 8, 2013, letter without seeking permission from the Court. However, the letter addresses a case decided by the Supreme Court after the filing of Defendants' Objection on which Plaintiffs rely. Accordingly, the Court will consider the letter, as Plaintiffs did not object to same.

4008711 at *1 (N.D. Cal. Dec. 30, 2006); *Capece v. DTCC*, 2005 U.S. Dist. LEXIS 42039, at *1 (S.D. Fla. Oct. 11, 2005)). As noted above, that is the practice with which Plaintiffs premise their Amended Complaint.

In other words, Plaintiffs allege that Defendants sold shares they did not own or borrow, or ever intend to own, which created and circulated unauthorized or counterfeit shares of Escala Group, diluting and artificially depressing their value. During May and December of 2006, Defendants allegedly entered millions of proprietary and customer short sale transactions without having reasonable grounds to believe that the securities could be borrowed and be available for delivery. (Compl.¶ 4).

Plaintiffs commenced this action with the filing of a Complaint on May 8, 2012, in the Superior Court of New Jersey, Law Division, Morris County. (CM/ECF No. 1). On June 7, 2012, Plaintiffs filed an Amended Complaint in the Superior Court of New Jersey. (CM/ECF No. 1). Defendants removed the action to this Court on July 17, 2012. At that time, as now, Defendants contend that removal is proper on two separate grounds: (1) the Court is vested with exclusive jurisdiction under Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa ("Exchange Act" or the "Act"); and (2) the Court is vested with original jurisdiction because Plaintiffs' claims raise, and arise under, federal law. Plaintiffs filed a motion to remand and for an award of attorneys' fees on August 16, 2012. (CM/ECF No. 11).

LEGAL STANDARD

When the magistrate judge addresses motions that are considered "dispositive," such as to grant or deny a motion to dismiss, a magistrate judge will submit a Report and Recommendation to the district court. 28 U.S.C. § 636(b)(1)(A); Fed. R. Civ. P. 72; L. Civ. R. 72.1(a)(2). The district court may then "accept, reject or modify, in whole or in part, the findings or recommendations made by the magistrate [magistrate judge]. The judge may also receive further evidence or recommit the matter to the magistrate with instructions." 28 U.S.C. § 636(b)(1)(C); *see also* L. Civ. R. 72.1(c)(2). Unlike an Opinion and Order issued by a magistrate judge, a Report and Recommendation does not have force of law unless and until the district court enters an order accepting or rejecting it. *United Steelworkers of Am. v. N.J. Zinc Co., Inc.*, 828 F.2d 1001, 1005 (3d Cir. 1987).

The standard of review of a magistrate judge's determination depends upon whether the motion is dispositive or non-dispositive. With respect to dispositive motions, the district court must make a *de novo* determination of those portions of the magistrate judge's Report to which a litigant has filed an objection. 28 U.S.C. § 636(b)(1)(C); Fed. R. Civ. P. 72(b); L. Civ. R. 72.1(c)(2); *see also State Farm Indem. v. Fornaro*, 227 F. Supp. 2d 229, 231 (D.N.J. 2002); *Zinberg v. Washington Bancorp, Inc.*, 138 F.R.D. 397, 401 (D.N.J. 1990) (concluding that the court makes a *de novo* review of the parts of the report to which the parties object).

As previously noted, Defendants object to the Report and Recommendation and argue that it

misconstrues the following: (1) the scope of exclusive jurisdiction under Section 27 of the Exchange Act, 15 U.S.C. § 78aa; and (2) Defendants' argument regarding federal question jurisdiction and the applicability of the Supreme Court's decision in *Grable & Sons Metal Prods., Inc. v. Darue Eng'g & Mfg.*, 545 U.S. 308, 313-14 (2005). Accordingly, the Court will determine de *novo* whether remand is appropriate in light of Defendants' objections. *See In re U.S. Healthcare*, 159 F.3d 142, 146 (3d Cir. 1998).

The party asserting federal jurisdiction by way of removal bears the burden of establishing that federal subject matter jurisdiction exists. *Samuel-Bassett v. KIA Motors Am., Inc.*, 357 F.3d 392, 396 (3d Cir. 2004). A defendant may remove to federal court an action brought in state court if the plaintiff could have filed the complaint within the original jurisdiction of the federal court. 28 U.S.C. § 1441. Courts should construe Section 1441 strictly and resolve all doubts in favor of remand. *Samuel-Bassett*, 357 F.3d at 396. The existence of federal jurisdiction must be decided on the face of the complaint. *Merrell Dow Pharms. v. Thompson*, 478 U.S. 804, 808 (1986) ("[T]he question whether a claim 'arises under' federal law must be determined by reference to the 'well pleaded complaint') (quoting *Franchise Tax Bd. of State of Cal. v. Contru. Laborers Vacation Trust for S. Cal.*, 463 U.S. 1, 9-10 (1983)).

DISCUSSION

Plaintiffs' Amended Complaint alleges that "Defendants substantially injured Plaintiffs while at the same time reaping enormous profits by knowingly and intentionally, creating, loaning and

selling unauthorized, fictitious and counterfeit shares of Escala stock, through various unlawful schemes and devices and by engaging in the unlawful practice of naked short sales." (Compl. ¶ 1). Specifically, the Amended Complaint asserts the following causes of action under state law: (1) violation of New Jersey RICO, N.J.S.A. 2C:41–1 et. seq. predicated on violations of the New Jersey Uniform Securities Law, N.J.S.A. 49:3–49 et seq., theft by taking in contravention of N.J.S.A. 2C:20–2 et seq., and theft by deception counter to N.J.S.A. 2C:20–4; (2) unjust enrichment; (3) unlawful interference with prospective economic advantage; (4) tortious interference with contractual relations; (5) unlawful interference with contractual relations; (6) third party beneficiary claims; (7) breach of covenant of good faith and fair dealing[2]; and (8) punitive and exemplary damages.

Notably, Plaintiffs do not dispute that the alleged unlawful conduct is predicated on a violation of Regulation SHO, 17 C.F.R. § 242.204, promulgated by the Securities and Exchange Commission ("SEC"). Indeed, the Amended Complaint also provides:

> [t]here are certain Defendants who have been fined millions of dollars by the [SEC] and the Financial Industry Regulatory Authority ("FINRA") for their intentional and persistent violation of the rules and regulations governing their unlawful short selling activities. These fines and sanctions, however, have not deterred

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[2] For the sake of completeness, the Amended Complaint designates both the breach of the covenant of good faith and fair dealing, and the third party beneficiary cause of action as "Count Six."

> these Defendants, which view them merely as "pocket change" and the "cost of doing business."

(Compl.¶ 6).

"'Federal courts are courts of limited jurisdiction,' possessing 'only that power authorized by Constitution and statute.'" *Gunn v. Minton*, 133 S. Ct. 1059, 1064 (2013) (quoting *Kokkonen v. Guardian Life Ins. Co. of America*, 511 U.S. 375, 377 (1994)). Generally, federal question jurisdiction may be invoked in two instances: (1) where plaintiffs plead a cause of action created by federal law; and (2) certain state-law claims that implicate significant federal issues. *Grable*, 545 U.S. at 312. Recently, the Supreme Court reiterated that the latter is "a 'special and small category' of cases." *Gunn*, 133 S. Ct. at 1064 (quoting *Empire Healthchoice Assurance, Inc. v. McVeigh*, 547 U.S. 677, 699 (2006)).

As noted above, Defendants contend that removal is proper on two separate grounds: (1) the Court is vested with exclusive jurisdiction under Section 27 of the Exchange Act; and (2) the Court is vested with original jurisdiction because Plaintiffs' claims raise, and arise under, federal law. The Court will address each.

1. The scope of exclusive jurisdiction under Section 27 of the Exchange Act

As an initial matter, no party points to controlling authority on the issue of whether Section 27 of the Exchange Act provides exclusive federal jurisdiction under the specific circumstances raised in this case, namely, where state claims are predicated on a violation of the Exchange Act. Defendants contend that "Plaintiffs' allegations that Defendant violated Regulation SHO's locate

requirement, which, with certain exceptions, compels short sellers to have reasonable grounds to believe that a stock can be borrowed before selling it short" brings those claims squarely within the purview of Section 27. (Defs.' Opp'n. 3).

Plaintiffs rely on *Fairfax*, to argue that the instant matter should be remanded. In that case, the defendants allegedly engaged in the practice of manipulative short selling, by conspiring to devastate the business and reputation of the plaintiff. Specifically, defendants allegedly disseminated corrupt and materially misleading equity research regarding plaintiff's business condition, defamed plaintiff, and harassed the plaintiff's agents and employees. 2007 WL 1456204, at * 1. The plaintiffs in that case filed a complaint in the Superior Court of New Jersey which asserted claims pursuant New Jersey's RICO and common law. The court remanded the case, holding, in relevant part, that "Section 27 does not grant . . . exclusive jurisdiction because [p]laintiffs' action is not an action brought to enforce the securities laws. Rather, Plaintiffs' allegations that Defendants violated provisions of the Exchange Act merely support Plaintiffs' state causes of action." 2007 WL 1456204, at * 5. Therefore, the court concluded that Section 28 saved plaintiffs' New Jersey RICO claims predicated on a violation of the Exchange Act. *Id.*[3]

Section 27 provides, in relevant part, as follows:

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[3] The court reasoned that "Section 28 of the Act preserves state causes of action: 'the rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist in law or equity.'" *Id.* (quoting 15 U.S.C. § 78bb) (alterations omitted).

> The district courts of the United States .... shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder.

15 U.S.C. § 78aa. "Section 27 of the Exchange Act confers exclusive jurisdiction upon the federal courts for suits brought to enforce the Act or rules and regulations promulgated thereunder." *Matsushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367, 370 (1996). As the case at bar is premised upon and its resolution depends on the alleged violation of a regulation promulgated under the Act, this Court has jurisdiction. *Saks v. Dietrick*, 663 F.3d 1065, 1068 (9th Cir. 2011); *Sparta Surgical Corp. v. NASD. Inc.*, 159 F.3d 1209, 1211-12 (9th Cir. 1998); *see D'Alessio v. NYSE, Inc.*, 258 F.3d 93, 101-02 (2d Cir. 2001). In addition, the *Fairfax* decision is distinguishable here because, unlike *Fairfax*, this case is premised upon enforcement of the federal Exchange Act and corresponding rules and regulations.

2. "Arising Under" Jurisdiction

Defendant argues that there is federal jurisdiction under 28 U.S.C. §§ 1331 and 1337 because Plaintiffs' causes of action depend upon the resolution of a federal issue, namely violation of the Exchange Act and federal regulations, and raise the substantial federal question of whether naked short sales in the National Clearance and Settlement System (the "National System") create "counterfeit" shares. Thus, Defendants maintain that the Report

and Recommendation misconstrues the applicability of the Supreme Court's decision in *Grable*, 545 U.S. at 313-14.

The doctrine of federal "arising under" jurisdiction "captures the commonsense notion that a federal court ought to be able to hear claims recognized under state law that nonetheless turn on substantial questions of federal law, and thus justify resort to the experience, solicitude, and hope of uniformity that a federal forum offers on federal issues." *Grable*, 545 U.S. at 312. The requisite inquiry to determine whether state law claims implicate sufficient federal issues is as follows: (1) does a state-law claim necessarily raise a stated federal issue; (2) is the federal issue actually disputed; (3) is the federal issue substantial; and (4) would entertaining the issue disturb the congressionally approved balance of federal and state judicial responsibilities. *Id.* at 314. Applying that test here, Plaintiffs' claims arise under federal law.

First, the federal issue is necessarily raised by Plaintiffs' claims. Indeed, those claims are predicated on Defendants' alleged naked short sales of Escala stock in violation of SEC Regulation SHO. To prevail on their various state law claims, therefore, Plaintiffs must show that the alleged naked short sales were illegal. As Defendants argue in their Opposition to Plaintiffs' motion to remand, "[i]f, as the SEC has concluded, naked short selling does not create counterfeit shares, Plaintiffs have no cognizable injury, and their claims must be dismissed." (Defs.' Opp'n. 30-31). It bears noting that Plaintiffs do not point to a New Jersey law or

regulation which similarly prohibits the type of alleged conduct at issue here.

Second, the federal issue is disputed. Defendants argue that "Plaintiffs' claims in this case are impossible to adjudicate without determining whether Plaintiffs are correct that so-called 'naked' short selling creates 'counterfeit shares.' This is because Plaintiffs' only basis for damages is their claim that the alleged 'counterfeit shares' diluted the value of their 'legitimate' Escala shares." (Def.'s Obj. 8). The viability of Plaintiffs' claims turns on that issue and Plaintiffs seek damages incurred as a result of the dilution and artificially depressed value of their shares.

In addition, the federal issue is substantial. *See Empire HealthChoice Assurance, Inc. v. McVeigh*, 574 U.S. 677, 700-01 (2006). Resolution of Plaintiffs' claims depends on the disputed issue. Determination as to whether the alleged naked short selling creates phantom shares would also impact subsequent lawsuits. Further, the issue is important to the federal system as a whole. Recently, in *Gunn v. Minton*, the Supreme Court considered whether a plaintiff's legal malpractice claim, which involved the viability of an experimental-use argument in an underlying patent case, arose under federal patent law. Expounding on the substantiality component of the *Grable* inquiry, the Supreme Court wrote: "it is not enough that the federal issue be significant to the particular parties in the immediate suit; that will *always* be true when the state claim 'necessarily raises' a disputed federal issue, as *Grable* separately requires. The substantiality inquiry under *Grable* looks instead to the importance of the issue to the federal system as a whole." 133 S.Ct. at 1066. The

Court in *Gunn* reasoned that the federal issue was not substantial because the federal patent question in that case was hypothetical "due to the backward-looking nature of a legal malpractice claim." *Id.* at 1066–67. Similarly, allowing state courts to resolve the case would not "undermine the development of a uniform body of patent law." *Id.* (alterations and quotations omitted).

It is worth noting that the issuance of the Report and Recommendation in this matter preceded the *Gunn* and, accordingly, Judge Hammer did not have the benefit of that decision. In this case, Defendants argue that "the existence of 'counterfeit shares' presents a substantial issue of federal law because it requires analysis of the regulations governing the federally sanctioned system for securities trading. Indeed, if naked short selling did create 'counterfeit shares,' as Plaintiffs claim—and the SEC has denied—then the entire federal system for short selling would be called into question." (Def.'s Obj. 9). Plaintiff, on the other hand, draws a parallel between the current New Jersey RICO claims and the attorney malpractice claim in *Gunn* to argue that the violation of Reguation SHO constitutes a "case within a case." (Pls.' Resp. 9). Therefore, they argue, "[a]pplying *Gunn* to the case at bar, there is an insufficient link in Plaintiff's state RICO claims to the substantial federal issues of law. Simply because Defendants claim that there are important issues to the federal system at stake does not make it true . . . ." (Pls.' Resp. 10).

In response, Defendants urge that Plaintiffs' theory threatens the uniform administration of the federal securities scheme. "To win relief, Plaintiffs must prove violations of Regulation SHO and other

federal regulations. In the absence of federal jurisdiction, such claims would be subject to state courts, not uniform federal adjudication. Plaintiffs must also prevail on their 'counterfeit share' theory to show any injury under their Complaint." (Defs.' Resp. 2). In addition, the theory of relief throws into question the entire federal scheme for regulating short selling. *Id.* "Specifically, if Plaintiffs prevail on this point, certain aspects of short selling explicitly permitted under the federal regulations would be subject to state liability, raising clear problems for the decisions made by federal regulators and the uniformity of the federal regulatory scheme." *Id.*

The Court finds the instant case distinguishable from the backward looking malpractice "case within a case" at issue in *Gunn*. Rather, as Defendants argue, other federal courts have found that the existence of "counterfeit shares" raises a substantial federal issue. *Pet Quarters, Inc. v. Depository Trust & Clearing Corp.*, 545 F. Supp. 2d 845, 848-49 (E.D. Ark. 2008); *Capace v. DTCC*, Civ. No. 00–5404, 2005 WL 4050118, at *8 (S.D. Fla. Oct. 11, 2005).

Plaintiffs urge that relevant case law demonstrates that "cases removed to federal court have consistently been remanded where the predicate acts alleged under state RICO statutes include violations of the federal securities laws, such as the Exchange Act." (Pls.' Mot. 1, 9-11) (citing *Fairfax*, 2007 WL 1456204, at *5 (D.N.J. May 15, 2007); *Meinders v. Fefco Sec. Inc.*, 865 F. Supp. 721, 723 (D. Colo. 1994); *Horowitz v. Marlton Oncology, P.C.*, 116 F. Supp. 2d 551, 554–556 (D.N.J. 1999)). In the context of a previous motion to remand, this Court has previously interpreted the two District of New Jersey cases cited by Plaintiffs and explained

that it declines to permit those decisions to "stand for the broad proposition that no federal interest, however important, can support federal jurisdiction if it is brought through the vehicle of state law." *Ortiz v. University of Medicine & Dentistry of New Jersey*, Civ. No. 08–2669, 2009 WL 2194782, at *4 (D.N.J. Mar. 18, 2009). In this case, the Court finds that the Amended Complaint sets forth a substantial question of federal law. Accordingly, the third prong of the *Grable* test is satisfied. 545 U.S. at 314.

Finally, entertaining the issue would not disturb the congressionally approved balance of federal and state judicial responsibilities. The instant matter primarily involves the issue of whether the complained of conduct is consistent with Defendants' obligations under the Exchange Act and regulations promulgated thereunder. *See Friedlander v. Troutman, Sanders, Lockerman & Ashmore*, 788 F.2d 1500, 1504 (11th Cir. 1986) (noting that "[t]he comprehensive scheme of statutes and regulations designed to police the securities industry is indicative of a strong federal interest."). In addition to the fact that the Court determined above that it has exclusive jurisdiction under Section 27 of the Exchange Act, it is worth reiterating that the decisions of other courts indicate that Congress intended federal courts to have exclusive jurisdiction of violations of the Exchange Act and rules and regulations promulgated thereunder. *Saks v. Die trick*, 663 F.3d 1065, 1068 (9th Cir. 2011); *D'Alessio v. NYSE, Inc.*, 258 F.3d 93, 101-02 (2d Cir. 2001); *Sparta Surgical Corp. v. NASD Inc.*, 159 F.3d 1209, 1211-12 (9th Cir. 1998). This case does not involve a specific body of law in which New Jersey has a similar interest, such as regulating professionals

within that jurisdiction. *See Gunn*, 2013 WL 610193, at * 10. Indeed, Plaintiffs do not point to a violation of New Jersey's securities law. In the case at bar, the essence of the Amended Complaint is that violation of Regulation SHO and other federal regulations gave rise to a number of state claims. Thus, this case is distinguishable from *Fairfax* which involved allegations of lawful short selling in conjunction with dissemination of corrupt and materially misleading equity research regarding the plaintiff's business condition, defamation, and harassment of plaintiff's agents and employees. Defendants argue that "so long as parties like Plaintiffs choose to assert their 'counterfeit shares' theory and other securities arguments in nominal state-law claims such as the ones presented here, federal courts would never have the opportunity to rule on them." (Defs.' Resp. 3). Accordingly, the instant matter would not disturb the balance between state and federal judicial responsibilities.

CONCLUSION

Therefore, for the reasons stated above, upon *de novo* consideration of the portions of the Report and Recommendation to which there were objections, the Court finds that there is federal jurisdiction over the instant matter. Accordingly, the Court DENIES Plaintiffs' motion to remand.

An appropriate Order accompanies this Opinion.

Dated: 3/18/13

/s/ Jose L. Linares
Jose L. Linares
United States District Judge

APPENDIX C

COURT OF APPEALS ORDER DENYING REHEARING

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 13-3693

GREG MANNING; CLAES ARNRUP; POSILJONEN AB; POSILJONEN AS; SVEABORG HANDEL AS; FLYGEXPO AB; LONDRINA HOLDING LIMITED,

Appellants

v.

MERRILL LYNCH PIERCE FENNER & SMITH, INC.; KNIGHT CAPITAL AMERICAS, a/k/a Knight Equity Markets L.P.; UBS SECURITIES LLC; E TRADE CAPITAL MARKETS LLC; NATIONAL FINANCIAL SERVICES LLC; CITADEL DERIVATIVES GROUP LLC; JOHN DOES 1-10 (names being fictitious); ABC COMPANIES 1 10
(names being fictitious), jointly, severally or in the alternative, individually

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SUR PETITION FOR REHEARING

Present: McKEE, Chief Judge, RENDELL, AMBRO, SMITH, FISHER, JORDAN, GREENAWAY, JR., VANASKIE, SHWARTZ, KRAUSE, and SLOVITER,* Circuit Judges

The petition for rehearing filed by appellees in the above-entitled case having been submitted to the judges who participated in the decision of this Court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular service not having voted for rehearing, the petition for rehearing by the panel and the Court en banc, is denied.

BY THE COURT,

s/ D. Brooks Smith
Circuit Judge

Dated: January 15, 2015

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* The vote of the Honorable Dolores K. Sloviter, Senior Judge of the United States Court of Appeals for the Third Circuit, is limited to panel rehearing.

APPENDIX D

AMENDED COMPLAINT

NEAL H. FLASTER L.L.C.
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Tel. No.: 973-822-7900
Attorney for Plaintiff
Greg Manning. et al

RECEIVED & FILED SUPERIOR COURT

2012 JUN - 7 P 12:30

CIVIL DIVISION

GREG MANNING; CLAES ARNRUP; POSILJONEN AB; POSILJONEN AS; SVEABORG HANDEL AS; FLYGEXPO AB; and LONDRINA HOLDING, LTD.,

Plaintiffs,

vs.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.; KNIGHT CAPITAL AMERICAS, L.P., formerly known as KNIGHT EQUITY MARKETS L.P.; UBS SECURITIES, L.L.C.;

SUPERIOR COURT OF NEW JERSEY LAW DIVISION: MORRIS COUNTY

DOCKET NO.: L-1173-12

Civil Action

E TRADE CAPITAL MARKETS L.L.C.; NATIONAL FINANCIAL SERVICES, L.L.C.; CITADEL DERIVATIVES GROUP, L.L.C.; JOHN DOES 1-10 (names being fictitious); and ABC COMPANIES 1-10 (names being fictitious), jointly, severally or in the alternative, individually

Defendants.

AMENDED COMPLAINT AND JURY DEMAND

Plaintiffs Greg Manning ("Manning"), residing at 4 Whitfield Court, Boonton Township, New Jersey 07932; Claes Arnup, residing at Hans Michelsensgatan 9, 11th floor, Malmo, Sweden, Posiljonen AB ("Posiljonen AB"), with its principal place of business located at Box 537, S-201 25 Malmo, Sweden; Posiljonen AS ("Posiljonen AS"), with its principal place of business located at Koebmagergade 2, DK-1050 Copenhagen, Denmark; Flygexpo AB ("Flygexpo"), with its principal place of business located at Box 321, S-72107 Vaesteraas, Sweden; Sveaborg Handel AS ("Sveaborg"), with its principal place of business located at Postboks 5098, Majorstua, —0301 Oslo, Norway; and Londrina Holding Ltd. ("Londrina"), with its principal place of business located at Boit Postal 260, L-2012 Luxemburg by way of complaint say:

NATURE OF ACTION

1. This is an action to recover damages incurred as a result of Defendants' massive manipulation of the market for the price of the common stock of Escala Group, Inc. ("Escala")[1] beginning May 9, 2006 ("Relevant Period I") through May 12, 2006 and again from December 1, 2006 through January 9, 2007 ("Relevant Period II"). As set forth herein, Defendants knowingly and intentionally engaged in the unlawful practice of naked short sales of Escala stock by creating, loaning and selling unauthorized, fictitious and counterfeit shares through various unlawful schemes and devices for the purpose of reaping enormous profits.

2. Defendants' unlawful conduct, occurring within the context of a pervasive and long- standing pattern of naked short selling of securities, constituted an unlawful form of market manipulation in violation, inter alia, of the New Jersey Racketeering Influenced and Corrupt Organization Act, N.J.S.A. 2C:41-1 et seq., the New Jersey Uniform Securities Act, N.J.S.A. 49:3-49 et seq., and various other New Jersey statutes and common law causes of action, including but not limited to theft by taking, theft by deception, unjust enrichment, unlawful interference with Plaintiff's economic advantage, tortious interference with Plaintiff's prospective economic advantage, breach of contract and breach of the covenant of good faith and fair dealing.

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[1] Escala is now known as Spectrum Group International, Inc.

3. To perpetrate this massive manipulation of the market price of Escala shares of stock, Defendants inter alia, designed their schemes and Employed their devices while engaged in a pattern of racketeering activity that resulted in their entering millions of proprietary and customer short sale transactions during the Relevant Period(s), while lacking reasonable grounds to believe that the securities could be borrowed and be available for delivery.

4. By undertaking the unlawful naked short selling of Escala stock, Defendants inter alia, increased the pool of tradable shares by electronically manufacturing fictitious and unauthorized phantom shares and using non-registered Escala shares to dilute the fixed percentage of the Plaintiffs' stock; however, in so doing, this caused the shares to dramatically decline in value with Defendants then selling or loaning these shares, receiving significant profits and fees for their unlawful actions. Thereafter, Defendants implemented a sophisticated scheme to conceal and cover-up their illegal conduct to avoid detection.

5. Defendants have been fined hundreds of thousands of dollars or more by regulatory agencies for their intentional and persistent violation of rules and regulations governing unlawful naked short sales of securities. However, these fines and sanctions have failed to deter Defendants from continuing to engage in business "as usual", viewing these sanctions as merely "pocket change" and the "cost of doing business". See Exhibit A, annexed hereto.

6. Plaintiffs seek entry of judgment against

each Defendant for statutory treble damages pursuant to the New Jersey Racketeering Influenced and Corrupt Organization Act, N.J.S.A. 2C:41-1 et seq., attorney's fees, compensatory damages, punitive damages, interest and costs of suit.

PARTIES AND NON PARTY PARTICIPANTS

A. Plaintiffs.

7. Plaintiff Manning, the owner of approximately 2.1 million shares in the Escala Group, Inc. ("Escala") during the Relevant Periods was a resident of Morris County and State of New Jersey at that time and currently resides at 4 Whitfield Court, Boonton Township, County of Morris and State of New Jersey.

8. Plaintiff Arnup, the owner of approximately 10,000 shares of stock in Escala during Relevant Period 1, is an individual residing at Hans Michelsensgatan 9, 11th floor, Malmoe, Sweden.

9. Plaintiff Posiljonen AB, the owner of approximately 60,000 shares of stock in Escala during the Relevant Period(s), is a company with its principal place of business located at Box 537, S-201 25 Malmoe, Sweden.

10. Plaintiff Posiljonen AS, the owner of approximately 13,100 shares of stock in Escala during the Relevant Period(s), is a company with its principal place of business located at Koebmagergade 2, DK-1050 Copenhagen, Denmark.

11. Plaintiff Flygexpo AB, the owner of approximately 30,000 shares of stock in Escala during the Relevant Period(s), is a company with its principal place of business located at Box 321,

S-72107 Vaesteraas, Sweden.

12. Plaintiff Sveaborg Handel AS, the owner of approximately 55,000 shares of stock in Escala during the Relevant Period(s), is a company with its principal place of business located at Postboks 5098, Majorstua,—0301 Oslo, Norway.

13. Plaintiff Londrina Holding Ltd., the owner of approximately 110,000 shares of stock in Escala during the Relevant Period(s), is a company with its principal place of business located at Boit Postal 260, L-2012 Luxemburg.

B. Entity Defendants.

14. Defendant Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch"), its subsidiaries, affiliates, successors or assigns, is a business corporation organized under the laws of Delaware that conducts business in or that affects New Jersey, is authorized to do business in New Jersey and has offices located at 1300 Merrill Lynch Drive, Pennington, New Jersey.

15. Defendant Knight Capital Group, Inc., ("Knight"), its subsidiaries, affiliates, successors or assigns, including but not limited to Knight Capital Americas, L.P., formerly known as Knight Equity Markets, L.P. ("Knight Equity"), is a business corporation organized under the laws of Delaware that conducts business in or that affects New Jersey, is authorized to do business in New Jersey and has its principal place of business located at 545 Washington Blvd., Jersey City, New Jersey.

16. Defendant UBS Securities, L.L.C. ("UBS"), its subsidiaries, affiliates, successors or assigns, conducts business in or that affects New

Jersey and has offices located at 480 Washington Blvd., Jersey City, New Jersey.

17. Defendant E*Trade Capital Markets, L.L.C. ("E*Trade"), its subsidiaries, affiliates, successors or assigns, is a subsidiary of E*Trade Financial Corporation, which conducts business in or that affects New Jersey and has offices located at Harborside Financial Center, 501 Plaza 2, 34 Exchange Place, Jersey City, New Jersey.

18. Defendant National Financial Services, L.L.C. ("National Financial"), its subsidiaries, affiliates, successors or assigns, conducts business in or that affects New Jersey and has offices located at 1000 Plaza, Jersey City, New Jersey.

19. Defendant Citadel Derivatives Group, L.L.C., its subsidiaries, affiliates, successors or assigns conducts business in or that effects New Jersey and has its offices located at 131 South Dearborn Street, #3100, Chicago, Illinois.

20. Defendants ABC Companies 1-10 (names being fictitious) are such companies or entities whose identities are unknown who acted individually or collectively with one or all of the other Defendants: a) to cause Plaintiffs to suffer financial harm; and b) to form, operate or manage an enterprise for the purpose of engaging in unlawful activity affecting trade or commerce in New Jersey , including but not limited to such activity which serves as the basis for relief under the New Jersey Racketeering Influenced and Corrupt Organization Act, N.J.S.A. 2C:41-1 et seq.; and c) to operate or manage an enterprise involved in unlawful activities affecting trade or commerce in New Jersey.

C. Non- Entity Individual Defendants.

21. Defendants John Does 1-10 (names being fictitious) are such persons whose identities are unknown who acted individually or collectively with one or all of the other Defendants to cause Plaintiffs: a) to suffer financial harm; and b) through a pattern of illegal racketeering activity, operate or manage an enterprise engaged in activities affecting trade or commerce in New Jersey, including but not limited activities which serves as the basis for relief under the New Jersey Racketeering Influenced and Corrupt Organization Act, N.J.S.A. 2C:41-1 et seq.

D. Non-party Participant(s).

22. Non-party Participant Escala had its principal place of business located at Passaic Avenue, in the Township of West Caldwell, County of Essex and State of New Jersey during the Relevant Period(s) in issue.

FACTS COMMON TO ALL CLAIMS

A. Background

1. Short Selling as a Lawful Trading Strategy

23. In a typical legal short selling transaction, a party known as a "Short Seller" speculates that the price of a stock will decline, and seeks to profit from that expected decline. To accomplish this, the Short Seller locates and then borrows shares of the subject company's stock from another shareholder in a transaction typically arranged by the broker dealer, and sells those borrowed shares on the open market at the existing price. The Short Seller completes the transaction, i.e., covers its short position, by replacing the shares it borrowed by purchasing the

subject company's stock at a later date, and returning the borrowed shares back to the lender. If the Short Seller's speculation that the stock price will decline is correct, the Short Seller will earn as profit the difference between the higher price at which it sold the borrowed shares and the lower price at which it subsequently replaced them. As an illustrative example, a Short Seller speculates that Stock X is currently overvalued at $50/share, and expects the share price to decline. The Short Seller (who does not own Stock X) borrows 100 shares of Stock X, and sells those shares on the open market at the existing $50/share price. The borrowed shares are delivered to the purchaser to complete the proper settlement of the short sale. If the stock price later falls to $45/share, and the Short Seller purchases 100 shares of the stock to replace the shares the short seller borrowed at $50 per share, the short seller has earned $5/share, minus any fees, commissions and/or interest it incurred in completing the transaction. If the stock is never borrowed then the profit is significantly greater by avoiding the borrowing fees, commissions and interest. If the subject company files for bankruptcy the short seller will never replace the shares that were sold.

24. When conducted in accordance with securities and other laws and regulations, short selling is a legal and accepted trading strategy. However, a critical requirement of a *lawful* short sale is that the Short Seller first makes an affirmative or reasonable determination that the shorted shares are available and the broker actually borrows or otherwise obtains the stock it sells. Indeed, securities laws and regulations require a

Short Seller to borrow the stock it sold and deliver that borrowed stock within three days of the short sale (the "Settlement Date"). This settlement cycle is known as "T+3". T+3 means that when a trade occurs, the participants to the trade deliver and pay for the security at the clearing agency three settlement days after the trade is executed so the brokerage firm can exchange those funds for the securities on that third settlement day.

2. Naked short sales of stock as an unlawful trading strategy used to manipulate the market in which securities are traded

25. In a "naked" short sale, the seller does not own, and does not borrow or arrange to borrow the securities in time to make delivery to the buyer within that standard T+3 Settlement Date. As a result, the seller fails to deliver the securities to the buyer when the delivery is due. If the Short Seller never borrows or otherwise obtains the stock it sold short, the Short Seller cannot convey or deliver authorized and legitimate stock to the purchaser. In those instances in which a Short Seller fails to borrow or otherwise obtain the stock it sold short, the purchaser is not precluded from completing the sale and obtaining the purchased stock.

26. Today, most settlements of securities trades are conducted electronically through a central depository, known as the Depository Trust and Clearing Corporation and its primary subsidiary, National Securities Clearing Corporation (collectively referred to herein as the "DTCC"), which accounts for the buying and selling of securities through electronic book entries (rather than transfer

of physical stock certificates).

27. In a typical securities transaction, the DTCC's electronic trading records reflect that the buyer "owns" the shares, and that the seller "owes" the purchased shares, which the seller is required to deliver by the Settlement Date. In a short sale, the DTCC still electronically transfers to the buyer the stock it purchased *even if the seller fails to deliver the shares it "owes" to the DTCC* ("Fail"). If the Short Seller Fails to deliver the stock it owes to the DTCC, the Short Seller has, in effect, electronically created and conveyed an unauthorized, fictitious and/or phantom share of stock to the buyer because the DTCC credits the buyer with owning shares that did not previously exist. The newly created shares are counterfeit shares because they were not authorized or issued by the company or registered for sale by the company with either the SEC or the market exchange on which the shares trade. These unauthorized, counterfeit shares, are created electronically by the Short Seller through an illegal short sale of a stock that the Short Seller did not own, deliver and/or intend on possessing in order to complete the settlement of the short sale.

28. In 2005, in response to pervasive manipulative conduct in the unlawful naked short sales of securities, the Securities and Exchange Commission ("SEC") adopted Regulation SHO ("Reg SHO"), 17 C.F.R. § 242.204. The general purpose of Reg SHO is to establish uniform "Locate" and "Close-Out" requirements and prevent unlawful naked short selling, in which market participants like the Defendants, sought to obtain illicit profits by selling or loaning stock at artificially depressed prices that they did not own, never intended to borrow or locate

for delivery to buyers and close-out by settling their trades.

29. The SEC articulated the pernicious effects of naked short selling on the securities markets, stating that:

> ...we are concerned that large and persistent fails to deliver may have a negative effect on the market in these securities. For example, large and persistent fails to deliver may deprive shareholders of the benefits of ownership, such as voting and lending. In addition, where a seller of securities fails to deliver securities on trade settlement date, in effect the seller unilaterally converts a securities contract (which should settle within the standard 3-day settlement period) into an undated futures-type contract, to which the buyer may not have agreed, or that may have been priced differently. Moreover, sellers that fail to deliver securities on trade settlement date may enjoy fewer restrictions than if they were required to deliver the securities within a reasonable period of time, and such sellers may attempt to use this additional freedom to engage in trading activities that deliberately and improperly depress the price of a security.
>
> In addition, many issuers and investors continue to express concern about extended fails to deliver in connection with "naked" short selling. To the extent that large and persistent fails

> to deliver might be indicative of manipulative "naked" short selling, which could be used as a tool to drive down a company's stock price, fails to deliver may undermine the confidence of investors. These investors, in turn, may be reluctant to commit capital to an issuer they believe to be subject to such manipulative conduct. In addition, issuers may believe that they have suffered unwarranted reputational damage due to investors' negative perceptions regarding large and persistent fails to deliver. Any unwarranted reputational damage caused by large and persistent fails to deliver might have an adverse impact on the security's price...

30. In November of 2007, former SEC Chairman Harvey Pitt derided the practice of naked short selling stating: "Phantom shares created by naked shorting are analogous to counterfeit money." Similarly, during a February 14, 2008 Senate Banking Committee Hearing, Senator Robert Bennett commented that through naked short selling it is becoming "increasingly...easier in this electronic world to give you counterfeit shares." The SEC also reaffirmed its ". . . zero tolerance for abusive naked short selling" by strengthening investor protection. Indeed, the SEC, which regulates federal securities laws that are substantially similar to New Jersey's Securities Act, has explicitly stated that selling stock short and failing to deliver shares at the time of settlement with the purpose of driving down the security's price" constitutes a "manipulative activity" that "in general, would violate various securities laws." *See*

www.sec.gov/spotlight/keyregshoissues.htm; *See also* SEC Release No. 34-.57511, p.3, File No. S7-08-08 (Mar. 17, 2008).

31. Naked short selling exacerbates volatility in the securities markets and damages bona fide shareholders of a company because it floods the market with, unauthorized, fictitious and/or counterfeit shares or entitlements, thereby diluting the value of each legitimate share of stock, diluting the shareholder's right to a fixed percentage of ownership of the company and diluting the shareholder's voting rights. Naked short selling is intended to deliberately depress the price of a security in order to maximize the profit that is made based on the difference between the price of the stock when it was sold and the price of the stock that is required to be delivered on the Settlement Date.

32. The DTCC is a corporation formed for the clearance and settlement of securities transactions, which is undertaken through a series of electronic systems. It was created in 1974 for, inter alia, the "prompt and accurate clearance and settlement of securities transactions" as "necessary for the protection of investors." Since 1999, the DTCC has controlled virtually all of the U.S. trade clearance and settlement processing of real stock issued by corporations that is held in brokerage accounts and did so during the relevant periods at issue in the within Complaint.

33. In 1981, further efforts were made to increase the speed of the settlement trade process through the advent of the DTCC stock borrow program by the DTCC within its overall system. That program created a massive lending pool of

shares from brokers' client margin accounts (i.e., brokerage accounts in which the broker lends the customer cash to purchase securities, which are securitized by both securities and cash), which facilitated securities trading. For example, if a prime broker is unable to deliver stock it sold within the T+3 Settlement Date, the prime broker could obtain shares to provide to the purchaser from the DTCC borrowing pool, allowing the trade to clear. When operated properly, the prime broker who sold the stock will replace the shares it owes to the DTCC. But, as set forth in detail herein, the Defendants violated the trading rules and regulations requiring that they actually deliver shares they owe to the DTCC to settle short sale transactions.

34. The Defendants, who are owners of the DTCC, have significant involvement and communication with, as well as influence over, the DTCC. For example, Defendants act as "DTCC member clearing firms," meaning that they are informed by the DTCC of the clearing and settling of trades and purportedly they assure that paperwork associated with a securities transaction is accurate. Moreover, Defendants, as prime brokers, play an integral role in short sale securities transactions; among other things, Defendants are responsible for locating shares of the shorted stock, borrowing the short stock, and delivering the shares by the T + 3 Settlement Date.

35. Defendants' illegal short selling activity has not been limited to Escala shares of stock, but is part of an ongoing pattern of unlawful naked short selling of securities of other companies. Because naked short selling was and is enormously lucrative

to the Defendants, the relatively minor sanctions and penalties assessed against them (when one considers the magnitude of the money directly connected to naked short selling) have failed to stop or even deter Defendants' from continuing to engage in such unlawful conduct. Defendants have a long and well documented history of being "recidivist" offenders of fraud and stock manipulation statutes and as one Court recently held, civil penalties and disgorgement even as high as $295 million are considered by the investment community to be merely, a "mild and modest cost of doing business."

B. The nature and scope of Defendants' unlawful scheme to manipulate Escala stock

36. Many of the Defendants unlawful acts and/or omissions are currently known only by them and are contained in documents and electronic records which they exclusively possess, control and maintain. However, Plaintiffs are aware of certain specific facts and circumstances that when analyzed within the context of publicly available records, clearly demonstrate a pattern of unlawful conduct.

37. Upon information and belief, during the Relevant Period(s), Defendants manipulated the price of Escala's common stock through a pattern of naked short selling by:

a) creating and/or using unauthorized counterfeit shares to increase the pool of tradable common stock which operated to dilute the shares owned by Plaintiffs;

b) selling and/or loaning unauthorized and counterfeit shares, thereby enabling Defendants to reap millions of dollars in

unlawful profits and fees while simultaneously injuring plaintiffs; and thereafter;

c) implementing a sophisticated scheme to conceal and cover up their unlawful conduct.

38. On the close of business on May 8, 2006, the share price of Escala stock was $32 a share. Its share value declined to $12.23 at the close of business on May 9, 2006, a 62% drop in value as the result of large scale selling of unlawful and counterfeit short shares which were neither borrowed nor delivered by Defendants to complete a legal sale and illegal trades used for the purpose of manipulating Escala's share price. The share value of the Escala stock continued to decline until it reached $4.00 a share on May 12, 2012.

1. Defendants' creation and/or use of fictitious and unauthorized phantom shares of Escala stock

39. Upon information and belief, Defendants traded in their own proprietary accounts and/or loaned Escala stock to their clients and others to complete short sales at times when Defendants neither possessed, nor had any intention of obtaining sufficient authorized stock to cover these transactions.

40. When a customer or prime broker seeks to sell a stock short, the prime broker or customer must first determine whether there are shares available to be borrowed. When the broker does not itself have shares available to borrow, the prime broker must ask other prime brokers whether they have shares available to lend and deliver to complete the short

sale. When one prime broker affirmatively states that it has shares available to lend and deliver, that statement is referred to as giving a "Locate."

41. Upon information and belief, Defendants gave and received false "Locates", knowing that they would not likely have to deliver the located shares if requested, thereby artificially increasing the pool of tradable Escala shares. Many of these same Defendants improperly provided Locates for Escala securities on the same dates for which they were failing to deliver Escala securities (i.e., Defendants were saying they had Escala securities available to lend to facilitate additional short selling at the same time they did not have sufficient Escala securities to cover past sales).

42. Upon information and belief, Defendants claimed to receive Locates from other Defendants (or non-party banks) on dates when those other Defendants (or non-party banks) did not have sufficient Escala securities to cover the alleged Locates and accepted Locates they knew were unreliable. Giving these false Locates allows the counter-party to the short sale transaction to complete the unauthorized sale and generate commissions without having to actually borrow the stock and incur borrowing costs.

43. When a Short Seller fails to deliver stock by the Settlement Date, the DTCC system indicates that a "Fail" occurred. Under DTCC rules, only the purchaser (or the Defendant prime broker representing it) has the ability to force the short seller to deliver the shares and clear out the "Fail" positions. Defendants, however, by implicitly agreeing not to require each other to clear out "Fails"

and instead, permitted "Fail" transactions to remain unfulfilled indefinitely, facilitated naked short sales by eliminating the need for a Defendant to actually locate Escala shares before loaning or selling Escala shares in conjunction with a short sale. It also deceives the market, the regulators and keeps the stock off of the Reg. SHO list, thus avoiding additional regulatory scrutiny and enforcement.

2. Defendants' unlawful and/or lending of unauthorized and fictitious shares of Escala stock

44. Each of the Defendants maintain their own proprietary accounts from which they conduct stock transactions on their own behalf. Analysis of the trading of Escala stock demonstrates patterns of trading that do *not* correlate to the activity recorded in the DTCC's electronic trading records and therefore, reflect a material deviation from various stock indices indicative of illegal naked short selling. Although there were significant amounts of Escala stock traded by the Defendants during the Relevant Periods, since the DTCC's records show little if any change in the Defendants' net position, the shares traded were not authorized or legitimate but were rather, counterfeit, fictitious and unauthorized.

3. The Events of May 2006 (Relevant Period I)

45. In May 2006, there were 9,037,738 shares of Escala stock on deposit at the DTCC where the actual shares issued by Escala in the public float are accounted for. In practice, the DTCC acts as a "bank" for the shares of publicly traded corporations held in brokerage accounts, with the DTCC accounting for the transfers of shares between firms.

There were at least 1.9 million shares of Escala stock held in cash or non marginable accounts, which could not be loaned out for short sales and therefore, could not be sold in the market. This reduced the actual public float at the DTCC to 7,137,738 million shares and of these shares, there were 5,615,754 million shares already shorted in May 2006, leaving only 1,521,904 million shares available in the public float to settle long and short sales.

46. Approximate Number of Escala shares available to settle trades in May 2006.

Settlement Date	***5/5/2006***	***5/12/2006***	***5/19/2006***
Shares on deposit with DTCC	9,037,738	9,037,738	9,037,738
Non-Shortable Shares	1,900,000	1,900,000	1,900,000
Short Interest	4 859,221	5.615,754	5,615,754
Approx. Shares Available	**2,278,517**	**1,521,984**	**1,521,984**
Escala's Trade Volume			
Shares Traded Between Periods		8,349,565	66,697,503
Shares traded on May 9th		6,944,513	

47. In May 2006, reported short interest was 5,615,754 shares or approximately 62% of the 9.1 million shares in the public float. DTCC records show that the public float remained consistent from May 2006 through January 2007 at less than 9.1 million shares. In essence, when the 1.9 million shares that were in the known accounts that could not be shorted were taken into consideration, 79% of the remaining shares on deposit at the DTCC were already shorted. The real shares issued by Escala that were in the public float, less established short

positions and shares in friendly hands in non-shortable accounts totaled approximately 1.5 million shares.

48. In May 2006, there was a significant increase in marketplace volume of Escala stock to over 97 million shares verses April's marketplace volume of 2.7 million shares, an increase of 35.5 times the previous monthly volume. The May marketplace volume of 97 million shares was a rotation of 10.8 times all of Escala's shares on deposit at the DTCC or averaging a turnover of the DTCC shares every two days for the month. The majority of this volume, 91,002,350 shares or 93% of the May 2006 volume, transacted in just 11 days, which equates to the entire number of shares on deposit turning over, every 1.1 days during this 11 day period. The 9.1 million shares on deposit at the DTCC were, in theory, turned over ten times in these 11 days. Moreover, shares in the real available float (shares on deposit at the DTCC less shares on deposit in non shortable accounts less short interest totaling approximately 1.5 million shares) turned over approximately 60 times in this 11 day period.

49. The incongruence between the number of Escala shares traded and the number of shares on deposit with the DTCC available to be traded is indicative of Defendants' unlawful naked short selling of Escala stock. Based on the movement of real shares at the DTCC, it would be impossible to trade 91 million shares in the 11 days in May 2006, as these transactions could not have been short sales because there were not significant numbers of shares to short.

50. In the months preceding May 2006; Escala shares of stock were failing to deliver in small quantities at the National Securities Clearing Corporation ("NSCC"), which indicated that there were few shares available to borrow to complete short sale settlements. Fails as a percentage of short interest were relatively small in 2006 and averaged 1.6% from January to April 2006. By May 10, 2006, the short interest reporting date, fails to deliver increased to 1,464,623 shares from a prior two day fail to deliver level of 52,229 shares. Fails as a percentage of short interest exploded to 26.1% of the reported interest. In the next 5 trading days, fails rose to 3,214,676 or 57% of the May reported short interest. Prior to May 10, 2006, there were few fails to deliver, indicating that the new fails to deliver were a result of newly reported shorted shares. The reported short interest for April 2006 was 4,859,221 and the reported short interest for May 2006 was 5,615,754, or a short interest increase of only 756,533 shares. The fails to deliver at the NSCC increased from the large volume of trading on May 9th and May 10th by 1,412,394 shares.

51. The May 9th and May 10th trading was reported in the May short interest period, with short interest growing by 756,533 shares. Since fails to deliver increased by 1.4 million shares, it appears that at least 655,861 shares that failed in delivery were not reported as short interest by Defendant clearing firms. These delivery failures represent sales of stock where no borrow could be obtained to complete settlement and shares were sold, but not owned by sellers (transactions which must be marketed short). Defendant clearing firms and market makers misrepresented the number of

shorted shares, which infused false and misleading information to the marketplace, at a time when they knew that Escala stock was failing to deliver; nonetheless, they continued to allow further failures to be traded, which impacted real supply and demand price discovery.

52. Reg SHO requires the exchanges to publish threshold lists identifying the stocks for which the number of shares that have failed to be delivered at DTCC's subsidiary, NSCC for at least five days exceeds (a) 0.5% of the issuer's outstanding common stock and (b) 10,000 shares. Prior to May 2006, Escala had been on and off the Reg SHO Threshold list three times, demonstrating previous failure to deliver because of the tight supply of available shares.

53. Short sellers of Escala stock failed to deliver 3,214,676 shares to the NSCC by May 17, 2006. Thus, short sellers were not borrowing shares for legitimate delivery (i.e., naked short selling) and were front running trades of real owners of Escala shares with shares that did not exist, using these trades to manipulate the pricing of Escala downward.

54. For May 2006, the NASDAQ issued a report identifying the largest volume traders by reporting Market Participants in Escala stock for the month, comprising 81% of the total market participant report volume:

Market Participant	***May 26 Reported Volume***	***Percentage of Volume***
Knight Equity Markets	31,984,624	45.16%
USB Securities, L.L.C.	12,096,879	17.08%
E*Trade Capital Markets, L.L.C.	9,034,783	12.76%

National Fin. Services, L.L.C.	4,158,568	5.87%
Total		80.87%

55. The Escala DTCC Inventory for May 2006 for the clearing firms for the traders identified above do not support the trade volumes by these Defendants. Since the four traders, Defendants Knight Equity Markets, L.P., USB Securities, L.L.C., E*Trade Capital Markets, L.L.C. and National Financial Services, L.L.C. accounted collectively for approximately 81% of the trading reported in market participant reports, it would be expected that these firms were trading significant volumes with each other and therefore, one of the firms' inventories would be significantly increasing while another firm would be significantly decreasing. However, this is not reflected in the DTCC tracking movement of shares, as set forth below.

56. Specifically, Market Participant(s):

a) Knight Equity Markets, L.P./CF Merrill Lynch, Trade Volume in May 2006 was 31,984,624 shares. The Clearing Firm inventory, calculated on a weekly basis was:

1) May 5, 2006-41,857 shares;

2) May 12, 2006-188,846 shares;

3) May 19, 2006--306,546 shares; and

4) May 26, 2006--272,946 shares.

b) UBS Securities, L.L.C., Trade Volume in May 2006 was 12,096,879 shares. The Clearing Firm inventory, calculated on a weekly basis was:

1) May 5, 2006 -- 48,830 shares;

2) May 12, 2006--225,139 shares;

3) May 19, 2006--256,900 shares; and

4) May 26, 2009--63,294 shares.

c) E*Trade Capital Markets, L.L.C., Trade Volume in May 2006 was 9,034,783 shares. The Clearing Firm inventory, calculated on a weekly basis was:

1) May 5, 2006--77,777 shares;

2) May 12, 2006--118,940 shares;

3) May 19, 2006--304,504 shares; and

4) May 19, 2006 was 394,000 shares.

d) National Financial Services, L.L.C., Trade Volume in May 2006 was 4,158,568 shares. The Clearing Firm inventory, calculated on a weekly basis was:

1) May 5, 2006 was 199,275 shares;

2) May 12, 2006 was 186,367 shares;

3) May 5, 2006 was 278,515 shares; and

4) May 19, 2006 was 463,410 shares.

57. The small movements of shares in the inventories of the Defendant clearing firms do not support settlements of 91 million shares executed in the marketplace during Relevant Period I with the real shares issued by Escala.

4. The Events of December 2006 (Relevant Period II)

58. In December 2006, Escala announced substantial changes to its Boards of Directors and Officers, stating that it would restate earnings for previous years beginning in 2003 and that the

restatements would be significant and material to its operation. However, the restatements were never put into effect.

59. There were substantial sales of Escala stock recorded in December 2006, despite:

a) its designation as SHO threshold security, which would have constrained large volumes of short sales unless the security was pre-borrowed to complete delivery;

b) the continued tight supply of available Escala shares; and

c) the still large short interest of 5,045,238 shares or 55% of the 9.1 million shares in the public float.

60. Approximate Number of Shares available to settle trades in December 2006.

Settlement Date	***12/1/ 2006***	***12/8/ 2006***	***12/15/ 2006***	***12/22/ 2006***	***12/29/ 2006***
Shares deposited with DTCC	9,092,4898	9,094,405	9,094,405	9,094,405	9,094,405
Non-Shortable Shares	1,900,000	1,900,000	1,900,000	1,900,000	1,900,000
Short Interest	5,110,988	5 110,988	5.045,238	5,045,238	5,045,238
Approx. Shares Available	2,081,501	2,083,417	2,149,167	2,149,167	2,149,659
Escala's Trade Volume					
Shares Traded		545,794	1,424,949	19,346,502	56,271,665

Between
Periods

61. In December 2006, the marketplace volume in Escala stock increased to 84.6 million shares, an increase of 30 times November's marketplace volume of 2.8 million shares. December's marketplace volume was a rotation of 9.3 times of all of Escala's shares on deposit at the DTCC, an average turnover of the DTCC shares every 2 days for the month. The majority of this volume, 79,282,758 shares or 94% of the December 2006 volume, transacted in just 6 trading days from December 19, 2006 through December 27, 2006, which equals the entire number of shares on deposit turning over every day during this period.

62. The 79 million shares traded in these six days could not have legally settled based on the movement of real shares at the DTCC. This volume could not have been short sales because there was no significant amount of shares to short. In fact, the short interest, while remaining over 5 million shares, actually decreased from December 2006 to January 2007.

63. Although the supply of Escala shares to trade was constrained in December 2006:

a) short interest stayed above 5 million shares;

b) shares outstanding remained stable;

c) 1.9 million shares were held in known ownership; and d) massive share volumes were sold without a significant increase in the fails to deliver to the NSCC.

64. Although there were almost 19 million

shares of Escala stock traded on December 19, 2006, there was a decrease in fails to 329,269 shares, a decline of 13,224 shares from the previous day. The fails to deliver peaked in December 2006 at slightly less than 1.3 million shares.

65. In the first 12 days in December 2006, the average closing price for a share of Escala stock was $4.88. On December 19th, the market opened at $5.00 and increased to a closing price of $8.60. The price continued to increase to a peak price on December 20th of $13.30. By January 8, 2007, the stock closed at $4.73 per share and by January 9th it closed at $4.54 a share.

66. For December 2006, the NASDAQ issued a report identifying the largest volume traders by reporting Market Participants in Escala shares, comprising 83.15% of the total market participant report volume:

Market Participant	***12/2006 Reported Volume***	***Percentage of Volume***
Knight Equity Markets, L.P.	16,556,363	27.39%
USB Securities, L.L.C.	11,153,215	18.45%
E*Trade Capital Markets, L.L.C.	14,476,559	23.95%
National Fin. Services, L.L.C.	4,725,698	7.82%
Citadel Derivatives Group, L.L.C.	3,349,785	5.54%
Total		83.15%

67. The Escala DTCC Inventory for December 2006 for the trader's clearing firms identified above do not support the trade volumes by these Defendants. Since the four traders, Defendants Knight Equity Markets, L.P., UBS Securities, L.L.C., E*Trade Capital Markets, L.L.C. and National Financial Services, L.L.C. accounted for 83.15% of the trading reported in Market

Participant reports for this period, the data would ordinarily reflect that these firms were trading significant volume with each other and therefore, one of the firms' inventories would be significantly increasing while another firm would be significantly decreasing. However, the DTCC tracking movement of shares does not support such conclusion.

68. For example, Market Participant(s):

a) Knight Equity Markets, L.P./CF Merrill Lynch, Trade Volume in December 2006 was 16,556,363 shares. The Clearing Firm inventory, calculated on a weekly basis was:

a) December 1, 2006--222,789 shares;

b) December 8, 2006--230,907 shares;

c) December 15, 2006-234,486 shares; and

d) December 22, 2006-219,497 shares.

b) E*Trade Capital Markets, L.L.C., Trade Volume in December 2006 was 14,476,559 shares. The Clearing Firm inventory, calculated on a weekly basis was:

a) December 1, 2006--391,844 shares;

b) December 8, 2006--319,393 shares;

c) December 15, 2006-370,602 shares;

d) December 22, 2006-334,703 shares; and

e) December 29, 2006 -511,101 shares.

c) UBS Securities, L.L.C., Trade Volume in December 2006 was 11,153,215 shares. The Clearing Firm inventory, calculated on a weekly

basis was:

a) December 1, 2006--133,448 shares;

b) December 8, 2006--127,121 shares;

c) December 15, 2006--94,13.1 shares;

d) December 22, 2006--77,513 shares; and

e) December 29, 2006--69,966 shares.

c) National Financial Services L.L.C., Trade Volume in December 2006 was 4,725,698 shares. The Clearing Firm inventory, calculated on a weekly basis was:

a) December 1, 2006--347,596 shares;

b) December 8, 2006--331,243 shares;

c) December 15, 2006-373,754 shares;

d) December 22, 2006-347,078 shares; and

e) December 29, 2006-499,437 shares.

d) Citadel Derivatives Group, L.L.C., Trade Volume in December 2006 was 3,349,785 shares. The Clearing Firm inventory, calculated on a weekly basis was:

a) December 1, 2006--452,183 shares;

b) December 8, 2006--140,348 shares;

c) December 15, 2006--55,672 shares; and

d) December 22, 2006--62,705 shares.

69. Combined NASDAQ Market Participation Reports for May and December 2006.

Market Participant	May 2006 Volume	December 2006 Volume	Total
Knight Equity Markets, L.P.	31,984,624	16,556,363	48,540,987
E*Trade Capital Markets	9,034,783	14,476,559	23,511,342
UBS Securities L.L.C.	12,096,879	11,153,215	23,250,094
National Financial Services	4,158,568	4,725,698	8,884,266
Citadel Derivatives, Group	1,603,235	3,349,785	4,953,020

70. Although there was almost 182 million shares of Escala stock traded in May 2006 and December 2006, settlement of this volume was unlikely given the accounting of the shares issued, the number of shares held in accounts that could not be shortened, inventory movement at the DTCC short sale data, the amount of previously shorted shares, and the number of shares failing to be delivered at the NSCC.

71. Defendants Knight Capital Group, Inc., through its subsidiary Knight Capital Americas, L.P., formerly known as Knight Equity Markets, L.P., was the largest trader by reported market participants in the stock of Escala for May and December 2006, with reported trade volumes of 31,984,624 shares in May 2006 and 16,556,363 shares in December 2006 for a combined total of 48,540,987 shares traded during these periods. Defendant Merrill Lynch acted as the clearing firm for the Knight Equity trades in May and December 2006.

72. Defendant UBS Securities, L.L.C. was a

significant trader by reported market participants in the stock of Escala for May and December 2006, with reported trade volumes of 12,096,879 shares in May 2006 and 11,153,215 shares in December 2006 for a combined total of 23,250,094 shares traded during these periods. Defendant UBS acted as the clearing firm for its trades.

73. Defendant E*Trade Capital Markets, L.L.C. was also a significant trader by reported market participants in the stock of Escala for May and December 2006, with trade volumes of 9,034,783 shares in May 2006 and 14,476,559 shares in December 2006 for a combined total of 23,511,342 shares traded during these periods. Defendant E*Trade Capital Markets, L.L.C. acted as the clearing firm for its trades.

74. Defendant National Financial Services, L.L.C. was another significant trader by reported market participants in the stock of Escala for May and December 2006, with trade volumes of 4,158,568 shares in May 2006 and 4,725,698 shares in December 2006 for a combined total of 8,884,266 shares traded during these periods. Defendant National Financial Services L.L.C. acted as the clearing firm for its trades.

5. Washed and Matched Trading

75. The massive trading volume in May and December 2006 were netted out as a pre-arranged washed and matched trading (e.g., washed is trading between related affiliates of a dealer; matched trades are between conspiring non related traders). High trade volumes without substantial inventories, lack of clearing firm inventory movements, no additional reported short interest and no significant increase in

"fails to deliver" were strong indications that the transactions in issue were intended solely for the purpose of adding artificial volume and thereby create an appearance of buying or selling by actual investors in a company, which is an unlawful practice.

76. The Defendant traders and/or clearing firms that engaged in conduct fostering or facilitating the naked short selling of Escala stock did so in breach of their duty as "gatekeepers" of the market to report suspicious transactions of unlawful naked short sales of stock to authorities. Since by their very nature, the fails to deliver represented sales of unregistered counterfeit securities that were not issued by Escala nor borrowed to deliver for legal settlement, by ignoring the obvious need for further inquiry, Defendants allowed Plaintiff's interests as shareholders of Escala to be diluted and thus, impaired.

77. There was so little movement of shares between the clearing firms, that settlements of the 91 million shares executed in the marketplace during the Relevant Period(s) were unsupportable.

78. The 182 million shares of Escala stock traded during the Relevant Period(s) is indicative by itself that the trading was manipulated by Defendants and not executed by real buyers and sellers, in the absence of buyers for Escala stock. The data reflects that there was an illegal bear raid on Escala securities, with massive volumes of non existent counterfeit stock used to manipulate pricing and front run trades ahead of the actual shareholders of Escala, including the Plaintiffs, with short sales being mis-reported to the marketplace.

Although Defendants, as market makers, traders and/or clearing firms, knew or in the alternative, should have known that Escala's stock was being short sold and in limited supply and therefore, that the shares were not being delivered for proper settlement, they actively participated in the trading of these securities, or alternatively, allowed it to occur.

79. Upon information and belief, to conceal their unlawful naked short selling of Escala stock, Defendants:

a. created false documentation of their trading, loaning and ownership in Escala shares;

b. failed to complete an order ticket for their securities transactions involving Escala shares that would ordinarily have permitted securities regulators to determine the amount of short sales that Defendants, acting as a prime broker, transacted and the identity of the parties involved in the short sale; and

c. knowingly and intentionally mis-marked order tickets to make transactions appear as "long" sales when in fact, they were short sales and concealed these unlawful activities by falsely reporting counterfeit or phantom shares on brokerage statements to investors, including the Plaintiffs in order to mislead them.

80. Upon information and belief, Defendants unlawfully used Rule 144 Restricted Stock in their possession to cover their own naked short sales or help other Defendants and/or third parties to cover

their own naked short sales of Escala stock and used stock designated as "Do Not Lend" to conceal and cover-up their own Fails to deliver resulting from their unlawful activity.

6. Pattern of unlawful short sales of securities by Defendants

81. Defendants have been engaged unlawfully for years in a pattern of repeated naked short selling of securities involving victims similarly situated as those of the Plaintiffs, utilizing the same or similar schemes as they employed in sales of Escala stock during the Relevant Period(s).

82. There have been numerous claims made and/or lawsuits filed against some or all of the Defendants by aggrieved shareholders, with sanctions imposed by regulators. For example, the Financial Industry Regulatory Authority ("FINRA") and other regulatory agencies filed complaints against Defendant Merrill Lynch, dating back to at least 2007, charging it with, inter alia:

a) effectuating short sale transactions in certain securities and failing to make an affirmative determination prior to affecting such transaction. Resolution date: August 20, 2004. Sanction Amount: $9,000.00.

b) effectuating short sale transactions in securities, failing to make an affirmative determination prior to affecting such transaction, executing short sale transactions and failing to report these transactions as required by law with a short sale modifier: Resolution Date: October 27, 2004. Sanction amount:

$97,000.00;

c) failing to report the correct symbol indicating whether transactions in eligible securities were a buy, sell, sell short, short Exempt or Cross for Transaction in reportable securities. Resolution Date: March 23, 2006. Sanction Amount: $45,000.00;

d) failing to report the correct symbol indicating whether transactions were buy, sell, sell short, sell short Exempt or Cross for Transaction in reportable securities. Resolution Date: September 24, 2008. Sanction amount: $242,500.00;

e) having a fail to deliver position in a threshold security for 13 consecutive settlement days and failing to timely allocate and close out its fail to deliver position. Subsidiary or affiliated company: Merrill Lynch Professional Clearing Corp. Resolution Date: June 26, 2007. Sanction amount: $1,250,000;

f) submitting inaccurate short interest position reports in NASDQ Securities to NASD, submitting inaccurate short interest position reports in securities listed on the NYSE to the NYSE, thereby impairing ability of the OATS system to link execution reports to related trade report. Subsidiary or affiliated company: Merrill Lynch Professional Clearing Corp. Resolution Date: May 27, 2010. Sanction amount: $47,500. See Exhibit A, annexed hereto.

83. FINRA and other regulatory agencies also filed complaints against Defendant UBS dating back to at least 2008, charging it with inter alia:

a) accepting customer short sale orders in certain securities and for, each order failed to make an affirmative determination that the firm would receive delivery of the security on behalf of the customer or that the firm could borrow the security on behalf of the customer for delivery by the settlement date, affecting short sale orders in certain securities and for itself, for each order failing to make an affirmative determination that the firm would receive delivery of the security or could borrow the security by the settlement date. Resolution Date: June 26, 2008. Sanction amount: $116,000.00.

b) submitted reports to OATS that contained inaccurate, incomplete or improperly formatted data and erroneously submitted Execution Reports routed away for handling and/or execution to OATS. Resolution Date: March 2007. Sanction amount: $65,000.00. See Exhibit A, annexed hereto.

84. On October 24, 2011, FINRA issued a Letter of Acceptance to Defendant UBS, "*Financial Industry Regulatory Authority Letter of Acceptance, Waiver and Consent No. 20080144511* ("Letter"). In the Letter, FINRA set forth its basis for settlement of an investigation commenced by its Department of Enforcement ("DOE") against UBS with regard to its long standing pattern of securities law violations for short selling activities.

85. While not admitting or denying the allegations made against it, UBS accepted and consented to entry of findings by FINRA (the

"Findings"), which included the following:

> UBS's Reg SHO supervisory and compliance system regarding locates and order marking of short sale orders was significantly flawed and resulted in a systemic supervisory failure that contributed to serious Reg SHO failures across the Firm's equities trading business." Id., at 2. "During the Relevant Period, the Firm's extensive locate violations occurred due to: (1) the misapplication of exceptions to Reg SHO's locate requirement...; (2) the inclusion of certain threshold and hard-to-borrow securities on the Firm's easy-to-borrow list...; (3) the Firm permitting certain clients to bypass the locate requirement when entering short sales...; and (4) the Firm failing to reasonably supervise that locates were obtained and/or documented for short sales entered through the Firm's Order Entry Systems. Id., at 3.
>
> As a result of these failures, the Firm improperly entered **millions of proprietary and customer short sale orders** at various times during the Relevant Period without having reasonable grounds to believe that the securities could be borrowed and available for delivery. A significant number of these short sale orders were in hard-to-borrow securities. Extrapolating from the quantified violations indicates that during the Relevant Period, **the Firm likely entered tens of millions of proprietary**

and customer short sale orders without having reasonable grounds to believe that the securities could be borrowed and available for delivery. The duration, scope and volume of the trading created a potential for harm to the integrity of the market. Id., at 3. (Emphasis added).

Additionally, the Firm mismarked millions of sale orders in its trading systems at various times during the relevant Period. Extrapolating from the quantified violations indicates the Firm likely mismarked **tens of millions of sale orders** during the Relevant Period. (Emphasis added). Many of these mismarked orders were short sales that were mismarked as "long" resulting in additional significant violations of Reg SHO's locate requirement. Id.

Moreover, the Firm also had significant reporting and record keeping violations resulting from the foregoing. UBS's mismarked sale orders flowed through to the Firm's blue sheet submissions, causing it to make inaccurate submissions of trading data to FINRA. ... Id.

Enforcement tested short sales entered through more than a dozen of the Firm's Order Entry Systems (OES's) during the three month period June 1, 2006 to August 31, 2006 (the "Sample Period"). Enforcement's investigation uncovered approximately 700,000 short sales that were effectuated without locates during

the Sample Period based upon improper applications of the exceptions to the locate requirement as described above. Given that the Firm improperly applied these exceptions in some cases for several years, extrapolating from the number of violations quantified during the Sample Period indicates that the Firm likely effected more than **ten million short sales in improper reliance** on an exception to Reg SHO's locate requirement. Id., at 5. (Emphasis added).

The Firm incorrectly programmed a trading system so that two proprietary trading strategies treated all short sale orders in Exchange Traded Funds ("ETFs") as if they were exceptions to Reg SHO's locate requirement. ... During the Sample Period, the Finn effected approximately 680,000 proprietary short sale orders in ETF's without locates using these two trading systems. ... [E]xtrapolating from the number of violations quantified during the Sample Period indicates that the Firm likely effected more than 7.4 million short sales in ETFs without valid locates." *Id.* "During the period beginning January 3, 2005 until approximately April 3, 2008, the Firm also improperly treated certain equity hedge transactions ... as exceptions to Reg SHO's locate requirements. ..." Id., at 6.

[T]he Firm created and distributed ETB (easy-to-borrow) lists that improperly included threshold and HTB (hard-to-

> borrow) securities to UBS's proprietary traders and clients, resulting in more than 900,000 short sale orders that were released for execution without valid locates." *Id.* "The Firm's DES platform was normally designed to block short sale orders that did not contain an entry indicating that a located had first been obtained. However, the Firm altered the programming for these 270 DES Clients to bypass this standard DES platform check. As a result, the clients configured to bypass the locate check had the ability to route short sale directly to the market for execution without locates ... Id., at 8.

See Exhibit B, annexed hereto. As a result of the FINRA Letter, UBS consented to a $12,000,000.00 sanction.

86. Despite the existence of regulatory prohibitions barring the practice of naked short selling of stock, Defendants' unlawful manipulation of the value of Escala shares was not an isolated incident but a regular course of dealing that resulted in the creation and circulation of millions of unauthorized and/or counterfeit Escala shares, thereby diluting and artificially depressing the value of the authorized shares of Escala owned by Plaintiffs during the Relevant Period(s).

87. By unlawfully flooding the market with unauthorized, fictitious and/or counterfeit Escala shares, Plaintiff's interests as share holders of Escala to a fixed percentage ownership of the company stock and associated voting rights were diluted, to their substantial detriment. Moreover,

Defendants' unlawful conduct created uncertainty in the market regarding the integrity of Escala and its management, which caused further depression in the value of the Escala stock..

COUNT ONE
N.J.S.A. 2C:41-2c.

88. Plaintiffs repeat and reallege each and every allegation set forth in Paragraphs 1-87 of the Complaint, as if incorporated by reference herein.

89. Plaintiffs are "persons" within the meaning of N.J.S.A. 2C:41-1b.

90. Each of the Defendants is a "person" within the meaning of N.J.S.A. 2C:41-lb.

91. Defendants Merrill Lynch, Knight Capital Americas, L.P., formerly known as Knight Equity Markets L.P., UBS Securities, L.L.C., E*Trade Capital Markets L.L.C., National Financial Services, L.L.C., Citadel Derivatives, L.L.C. and ABC Companies 1-10 (names being fictitious) acting independently and/or by and through its subsidiaries, affiliates, related entities, agents, servants or employees or collectively each constituted a separate "enterprise" engaged in or the activities of which affected trade or commerce in New Jersey within the meaning of N.J.S.A. 2C:41-1c.

92. Defendants John Does 1-10 (names being fictitious) are "persons" within the meaning of N.J.S.A. 2C:41-lb. each employed by or associated with these enterprise(s), who conducted, managed, operated or participated, directly or indirectly in the conduct of each separate enterprise's affairs through a pattern of predicate acts or crimes as defined by N.J.S.A. 41-1a. and by multiple, repeated and

continuous acts knowingly and willfully committed violations of the New Jersey Racketeering Influenced and Corrupt Organization Act, N.J.S.A. 2C:41-1 et seq., including but not limited to N.J.S.A. 2C:41-2c., and inter alia, the predicate criminal acts set forth in N.J.S.A. 2C:41- 1 a.(n), "theft and all crimes defined in Chapter 20 of Title 2C of the New Jersey Statutes" and (p) "fraud in the offering, sale or purchase of securities".

93. In engaging in at least two incidents of predicate acts in the past ten years, as set forth herein, Defendants, in their capacity as enterprises, participated in racketeering activity embracing criminal conduct involving Escala that was not isolated and had either the same or similar purpose, results, participants or victims or methods of commission that are otherwise interrelated by distinguishing characteristics.

94. The pattern of predicate acts committed by Defendants, in their capacity as enterprises, is continuing, is substantial in nature and poses a threat of continuing in the future because they amount to a regular course of doing business.

95. Plaintiffs were injured in their business or property as a result of Defendants' predicate criminal acts committed in violation of N.J.S.A. 41-1a. [e.g., theft pursuant to subsection (n) and fraud in the offering, sale or purchase of securities pursuant to subsection (p)] committed by Defendants with the knowledge and intent that they were acting in furtherance of a pattern of racketeering activity.

A. Violations of New Jersey Uniform Securities Law, N.J.S.A. 49:3-49 et seq.

96. Defendants' conduct constituting criminal predicate acts of racketeering activity as defined by N.J.S.A. 2C:41-1a. (p) include but are not limited to, the following:

a) Willfully employing a device, scheme, or artifice to defraud in connection with an offer to sell, sale or purchase any security;

b) Willfully engaging in an act, practice, or course of business that operates or would operate as a fraud or deceit upon a person;

c) Willfully effecting a transaction in a security which involves no change in the beneficial ownership of the security for the purpose of creating a false or misleading appearance of active trading in a security or with respect to the market for a security;

d) Willfully misappropriating, converting or improperly withholding funds or other property;

e) Willfully selling or offering for sale unregistered, unauthorized, fictitious and/or counterfeit Escala shares; and/or

f) Wilfully employing a deceptive or fraudulent device, scheme or to manipulate the market in the security.

97. As the market for Escala stock was intended to operate in an efficient and honest

Manner, Plaintiffs relied upon the assumption that the market for Escala stock was free from manipulation.

98. Defendants, by each knowingly and intentionally engaging in the conduct described herein, (e.g., selling Escala stock short at times when Defendants neither possessed nor intended to obtain Escala stock to deliver by the Settlement Date and by creating and trading in unauthorized, fictitious, and/or counterfeit Escala shares) Defendants willfully violated, attempted to violate, aided and abetted, and solicited another to willfully violate the New Jersey Uniform Securities Law, N.J.S.A. 49:3-47 et seq., which prohibits "generally, any course of conduct or business which is calculated or put forward with intent to deceive the public or the purchaser of any security or investment advisory services as to the nature of any transaction or the value of such security".

99. Defendants, by making phantom loans of counterfeit Escala stock to facilitate naked short sale transactions, engaged inter alia, in the employment of an "artifice, agreement, device or scheme to obtain money, profit or property by any of the means herein set forth or otherwise prohibited by [the New Jersey Uniform Securities Law, N.J.S.A. 49:3-47 et seq.]"

100. The SEC has expressly noted that naked short selling involves the omission of a material fact. Defendants, by each knowingly and intentionally engaging in the conduct as described herein, (e.g., selling Escala stock short at times when they neither possessed nor intended on obtaining Escala stock to deliver by the Settlement Date and by creating and trading in unauthorized, fictitious, and/or counterfeit

Escala shares), made untrue statements of a material fact or omissions of material facts necessary in order to make the statements made, in light of the circumstances under which they were made not misleading, in violation of the New Jersey Uniform Securities Law, N.J.S.A. 49:3-47 et seq.

101. Further, upon information and belief, Defendants, in violation of the New Jersey Uniform Securities Law, N.J.S.A. 49:3-47 et seq.:

a) Knowingly and intentionally charged clients, customers, banks or others, fees, commissions and/or interest for "loaning" shares of stock that the Defendants never loaned;

b) Knowingly and intentionally permitted a pattern of allowing failure to deliver or receive positions from the same counter-party or for the same customers/ clients;

c) Knowingly and intentionally failed to conduct or request buy-ins from clients or counterparties;

d) Knowingly and intentionally continued to accept, permit or facilitate short sales or other transactions (e.g., flex options, conversions) for a customer or a prime broker that had failed to deliver on numerous occasions;

e) Knowingly and intentionally continued to accept, permit or facilitate short sales of a stock that had repeated net failures to deliver or receive;

f) Knowingly and intentionally permitted, facilitated and/or engaged in conversion,

reverse conversion, flex option or other transactions that they knew were unlawful;

g) Knowingly and intentionally permitted, facilitated and/or engaged in transactions with customers/clients that it knew intended on violating or circumventing the law;

h) Knowingly and intentionally permitted, facilitated and/or engaged in transactions where they knew that stock would not be borrowed and/or delivered because of a negative rate (e.g., it would cost money to borrow the stock);

B. Theft By Taking (N.J.S.A. 2C:20-2)

102. Defendants' violations of N.J.S.A, 2C:20-2 et seq., constituted the commission of the offenses of theft, a predicate act of racketeering activity as set forth in N.J.S.A. 2C:41-1(n).

103. A person commits the offense of theft when he/she unlawfully takes or, being in lawful possession thereof, unlawfully appropriates property of another with the intention of depriving him/her of the property, regardless of the manner in which the property is taken or appropriated.

104. Plaintiffs held a property interest in their authorized issued shares of Escala stock and all rights appertaining thereto. Since at any point in time there is a finite amount of authorized and issued Escala stock, when the Defendants created fictitious and/or counterfeit stock through naked short sales, they diminished and/or diluted from each legitimate owner of authorized and issued

Escala stock, an amount proportionate to the amount of fictitious and/or counterfeit Escala shares they created.

105. Each Defendant committed, attempted to commit, aided and abetted, solicited another to commit, or engaged in acts constituting the offense of theft by taking the property of Escala and Escala shareholders, including Plaintiffs. Upon information and belief, Defendants unlawfully took the property of Plaintiffs, with the intention of depriving them of that property by, inter alia, selling Escala stock short at times when they neither possessed nor intended on obtaining Escala stock to deliver by the Settlement Date and by creating and trading in unauthorized, fictitious, and/or counterfeit Escala shares. By so doing, Defendants took, in whole or in part, shares of Escala stock, which had not been issued or authorized to be issued, for which Escala was never paid, and thereby deprived Escala (and Plaintiffs, as shareholders of the company) of the right to exclusive possession and control over this property and any financial benefit from the introduction of its shares into the marketplace.

106. Further, Defendants engaged in theft by taking by purporting to loan short sellers Escala stock that the Defendants did not own nor had any intention of obtaining and never did obtain. Upon information and belief, Defendants charged short sellers fees for these sham "loans" of stock. Thus, the creation of fictitious and/or counterfeit shares of Escala through the unlawful naked short sales of counterfeit stock and the fees Defendants charged for these sham loans constituted an unlawful taking of property in violation of N.J.S.A. 2C:20-2.

107. As stated herein, Defendants engaged in similar unlawful naked short selling of counterfeit securities of other companies for which they earned illicit profits and fees. The illegal naked short selling engaged in by the Defendants were not isolated incidents or parts of the same transaction but rather constituted a regular way or course of conduct of each of the Defendants, acting in their capacity as enterprises, involving a pattern of racketeering activity that spanned several years, by which Defendants derived, directly or indirectly, personal property including money.

C. Theft By Deception (N.J.S.A. 2C:20-4)

108. Defendants' violations of N.J.S.A. 2C:20-4 et seq., constituted the commission of the offense of theft by deception, a predicate act of racketeering activity as set forth in N.J.S.A. 2C:41-1(n).

109. A person commits the offense of theft by deception when he/she purposely obtains the property of another by deception, which means that the Defendants unlawfully brought about a transfer or an apparent transfer of a legal interest in the property either to the Defendant or to another person. A person deceives another if he/she purposely 1) creates or reinforces a false impression, including false impressions as to law, value, intention, or other state of mind or 2) prevents another from acquiring information which would affect his/her judgment of a transaction.

110. Defendants, by inter alia, engaging in the unlawful naked short sale of counterfeit Escala shares based on promises to borrow Escala stock that it did not borrow and had no intention of borrowing, committed the crime of theft by deception

prohibited by N.J.S.A. 2C:20-4.

111. The multiple acts of racketeering committed by the Defendant enterprises in violation of the New Jersey Racketeering Influenced and Corrupt Organization Act N.J.S.A. 2C:41-1 et seq. were interrelated, part of a common and continuous pattern of fraudulent conduct perpetrated for the same or similar purposes, thus constituting a regular way of doing business by each separate Defendant enterprise, that is a pattern of racketeering activity as defined by the N.J. S.A. 2C:41-1d.(1) and (2) by each of the Defendants, acting in their capacity as enterprises.

112. Each of the Defendant enterprises willfully, knowingly, and intentionally participated in these separate but related schemes to defraud Plaintiffs and engaged in a pattern of racketeering activity described herein as a regular way of doing its business with the knowledge and the intention that Plaintiff would be defrauded by their conduct.

113. As a direct and proximate result of each of the Defendants' wrongful acts, Plaintiffs have been injured and sustained substantial damages.

WHEREFORE, Plaintiffs demand separate judgments against each Defendant enterprise, that is, Merrill Lynch, Pierce, Fenner & Smith, Inc., Knight Capital Americas, L.P., formerly known as Knight Equity Markets L.P., UBS Securities, L.L.C., E* Trade Capital Markets L.L.C., National Financial Services, L.L.C., Citadel Derivatives, Group L.L.C., John Does 1-10 (names being fictitious) and ABC Companies 1-10 (names being fictitious) for statutory trebled damages, attorney's fees, interest and costs of suit.

COUNT TWO
N.J.S.A. 2C:41-2a.

114. Plaintiffs repeat and reallege each and every allegation set forth in Paragraphs 1-113 of the Complaint, as if incorporated by reference herein.

115. Plaintiffs are "persons" within the meaning of N.J.S.A. 2C:41- 1 b.

116. Each of the Defendants are "persons" within the meaning of N.J.S.A. 2C:41 -1b .

117. Each Defendant enterprise, that is, Merrill Lynch, Knight Capital Americas, L.P., formerly known as Knight Equity Markets L.P., UBS Securities, L.L.C., E* Trade Capital Markets L.L.C., National Financial Services, L.L.C., Citadel Derivatives, L.L.C. and ABC Companies 1-10 '(names being fictitious) acting independently and/or by and through its subsidiaries, affiliates, related entities, agents, servants or employees or collectively constitute a separate "enterprise" within the meaning of N.J.S.A. 2C:41-lc.

118. Defendants John Does 1-10 (names being fictitious) are "persons" within the meaning of N.J.S.A. 2C:41-lb, separately employed by or associated with each Defendant enterprise who conducted, managed, operated or participated, directly or indirectly in the conduct of each Defendant enterprise's affairs through a pattern of predicate acts or crimes as defined by N.J.S.A. 41-1a. and as such, by a pattern of multiple, repeated and continuous acts, knowingly and willfully committed violations of the New Jersey Racketeering Influenced and Corrupt Organization Act, N.J.SA. 2C:41- 1 et seq., specifically N.J.S.A. 2C:41-2a. that makes it unlawful for any person who has received

income derived, directly or indirectly from a pattern of racketeering activity to use or invest, directly or indirectly any part of the income, or the proceeds of the income in acquisition of any interest in, or the establishment or operation of any enterprise engaged in or the activities of which affect trade or commerce through the use of predicate criminal acts defined by N.J.S.A. 2C:41-1a., including but not limited to subsection (n)"theft and all crimes defined in Chapter 20 of Title 2C of the New Jersey Statutes" and (p) "fraud in the offering, sale or purchase of securities".

119. Each Defendant enterprise, engaging in at least two incidents of unlawful criminal acts as set forth herein, did so as a regular way of doing business that was not isolated, and engaged in unlawful conduct, including but not limited to creating false documentation of their trading, loaning and ownership in shares of Escala and other victims similarly situation and participated in racketeering activity embracing criminal conduct that had either the same or similar purpose, results, participants or victims or methods of commission or which was otherwise interrelated by distinguishing characteristics, in violation of N.J.S.A. 2C:41-2a.

120. The pattern of predicate acts committed by each Defendant enterprise is continuing, substantial in nature and poses a threat of continuing in the future because these acts amount to a regular way doing business by each of the Defendant enterprises.

121. Plaintiffs were injured in their business or property as a result of Defendants' committing unlawful criminal acts as defined by N.J.S.A. 41-1a.

(e.g., theft pursuant to subsection (n) and fraud in the offering, sale or purchase of securities pursuant to subsection (p), amongst others) with the knowledge and intent that they were acting in furtherance of a pattern of racketeering activity in violation of N.J.S.A. 2C:41-2a.

122. As a direct and proximate result of Defendants' wrongful conduct, Plaintiffs have been injured and have sustained substantial damages.

WHEREFORE, Plaintiffs demand separate judgments against each Defendant enterprise, that is, Merrill Lynch, Pierce, Fenner & Smith, Inc., Knight Capital Americas, L.P., formerly known as Knight Equity Markets L.P., UBS Securities, L.L.C., E* Trade Capital Markets L.L.C., National Financial Services, L.L.C., Citadel Derivatives, Group L.L.C., John Does 1-10 (names being fictitious) and ABC Companies 1-10 (names being fictitious) for statutory treble damages, attorney's fees, interest and costs of suit.

COUNT THREE
UNJUST ENRICHMENT

123. Plaintiffs repeat and reallege each and every allegation set forth in Paragraphs 1-122 of the Complaint as if incorporated by reference herein.

124. Each Defendant enterprise, while engaged in naked short selling of counterfeit shares of Escala stock in its business knew or, in the alternative, should have known that their artificial manipulation of Escala's stock value would directly and negatively impact Plaintiff's financial expectations and contractual rights as a shareholder in Escala, while providing Defendants with significant financial gain.

125. Each Defendant enterprise's unlawful manipulation of the market for Escala stock unjustly enriched themselves at Plaintiffs' expense, such that retention of these benefits would be inequitable.

126. As a result of each Defendant enterprise's unlawful conduct, Plaintiffs expectations of financial gain under ordinary market conditions was denied, to their substantial detriment.

127. As a direct and proximate result of each Defendant enterprise's actions, Plaintiffs have suffered damages.

WHEREFORE, Plaintiffs demand separate judgments against each Defendant enterprise, that , Merrill Lynch, Pierce, Fenner & Smith, Inc., Knight Capital Americas, L.P., formerly known as Knight Equity Markets L.P., UBS Securities, L.L.C., E* Trade Capital Markets L.L.C., National Financial Services, L.L.C., Citadel, Group. L.L.C., John Does 1-10 (names being fictitious) and ABC Companies 1-10 (names being fictitious) for compensatory damages, attorney's fees, interest and costs of suit.

COUNT FOUR
UNLAWFUL INTERFERENCE WITH PLAINTIFF'S ECONOMIC ADVANTAGE

128. Plaintiffs repeat and reallege each and every allegation set forth in Paragraphs 1-127 of the Complaint as if incorporated by reference herein.

129. Plaintiffs had a reasonable expectation of economic advantage or benefit as a result of their acquisition of Escala stock.

130. Each Defendant enterprise knew, or in the alternative, should have known of Plaintiffs'

expectancy of economic advantage by their ownership of Escala stock.

131. Each Defendant enterprise's conduct in inter alia, engaging in the unlawful naked short selling of counterfeit Escala Stock was wrongfully undertaken without justification as a result of which, Plaintiffs' expectation of economic advantage or benefit was impaired to their substantial detriment.

132. But for the Defendant enterprise's wrongful conduct, it is reasonably likely that Plaintiffs would have realized their economic advantage or benefit by their acquisition of Escala stock.

133. As a direct and proximate result of each Defendant enterprise's unlawful interference with Plaintiffs' economic advantage, Plaintiffs have suffered damages.

WHEREFORE, Plaintiffs demand separate judgments against each Defendant enterprise, that is, Merrill Lynch, Pierce, Fenner & Smith, Inc., Knight Capital Americas, L.P., formerly known as Knight Equity Markets L.P., UBS Securities, L.L.C., E* Trade Capital Markets L.L.C., National Financial Services, L.L.C., Citadel Derivatives Group, L.L.C., John Does 1-10 (names being fictitious) and ABC Companies 1-10 (names being fictitious) for compensatory damages, attorney's ' fees, interest and costs of suit.

COUNT FIVE
TORTIOUS INTERFERENCE WITH PLAINTIFF'S CONTRACTUAL RELATIONS

134. Plaintiffs repeat and reallege each and

every allegation set forth in Paragraphs 1-133 of the Complaint as if incorporated by reference herein.

135. Plaintiffs' purchase or acquisition of shares of stock in Escala was for investment purposes and undertaken pursuant to a contract.

136. Each Defendant enterprise knew, or in the alternative, should have known of the existence of that relationship by virtue of Plaintiffs' status as a shareholder in Escala.

137. Defendants intentionally and maliciously with motive to harm and without justification, interfered with Plaintiffs' contract with Escala by engaging inter alia, in the unlawful naked short selling of counterfeit shares of stock by inducing, procuring or causing a breach or termination of Plaintiffs' contractual relationship.

138. In the alternative, each Defendant enterprise, if it did not act out of malice, but rather for profit or to enhance its financial position, engaged in conduct affecting Plaintiffs that went far beyond or transgressed generally accepted standards of morality, that is a violation of standards of socially acceptable conduct.

139. But for each Defendant enterprise's conduct, Plaintiffs would have continued to own their shares of Escala stock and would not have suffered losses in the share value of Escala stock.

140. As a direct and proximate result of each Defendant enterprise's actions, Plaintiffs have suffered damages.

WHEREFORE, Plaintiffs demand separate judgments against each Defendant enterprise, that is, Merrill Lynch, Pierce, Fenner & Smith, Inc.,

Knight Capital Americas, L.P., formerly known as Knight Equity Markets L.P., UBS Securities, L.L.C., E* Trade Capital Markets L.L.C., National Financial Services, L.L.C., Citadel Derivatives Group, L.L.C. John Does 1-10 (names being fictitious) and ABC Companies 1-10 (names being fictitious) for compensatory damages, attorney's fees, interest and costs of suit.

COUNT SIX
UNLAWFUL INTERFERENCE WITH CONTRACTUAL RELATIONS

141. Plaintiffs repeat and realleges each and every allegation set forth in Paragraphs 1-140 of the Complaint as if incorporated by reference herein.

142. Plaintiffs had the right to enjoy the fruits and advantages of their enterprise, industry and skill, free from unjustified and wrongful interference by their investment in Escala stock.

143. Each Defendant enterprise, by inter alia, engaging in the unlawful naked short selling of counterfeit shares of Escala stock, unjustifiably interfered with Plaintiffs contract rights and/or reasonable expectations derived therefrom.

144. But for each of the Defendant enterprise's unlawful activity, Plaintiffs would have realized their economic advantage or benefit.

145. As a direct and proximate result of each Defendant enterprise's actions, Plaintiffs have suffered damages.

WHEREFORE, Plaintiffs demand separate judgments against each Defendant enterprise, that is Merrill Lynch, Pierce, Fenner & Smith, Inc., Knight Capital Americas, L.P., formerly known as

Knight Equity Markets L.P., UBS Securities, L.L.C., E* Trade Capital Markets L.L.C., National Financial Services, L.L.C., Citadel Derivatives Group, L.L.C., John Does 1-10 (names being fictitious) and ABC Companies 1-10 (names being fictitious) for compensatory damages, attorney's fees, interest and costs of suit.

COUNT SEVEN
THIRD PARTY BENEFICIARY CLAIMS

146. Plaintiffs repeat and realleges each and every allegation set forth in Paragraphs 1-145 of the Complaint as if incorporated by reference herein.

147. Plaintiffs are the intended third party beneficiaries individually and/or as a class of any and all agreements and/or contracts entered into by each Defendant enterprise in furtherance of their roles as market makes, traders and clearing firms in their transacting short sales of Escala stock.

148. Upon information and belief, each Defendant enterprise intended that Plaintiffs, individually and as a class were to receive a benefit from these agreements and/or contracts.

149. As a direct and proximate result of each Defendant enterprise's failure to abide by their agreements and/or contracts, whether by intention, design or otherwise, Plaintiffs have suffered damages.

WHEREFORE, Plaintiffs demand separate judgments against each Defendant enterprise, that is, Merrill Lynch, Pierce, Fenner & Smith, Inc., Knight Capital Americas, L.P., formerly known as Knight Equity Markets L.P., UBS Securities, L.L.C., Et Trade Capital Markets L.L.C., National

Financial Services, L.L.C., Citadel Derivatives Group, L.L.C., John Does 1-10 (names being fictitious) and ABC Companies 1-10 (names being fictitious) for compensatory damages, attorney's fees, interest and costs of suit

COUNT EIGHT
BREACH OF COVENANT OF GOOD FAITH AND FAIR DEALING

150. Plaintiffs repeat and realleges each and every allegation set forth in Paragraphs 1-149 of the Complaint as if incorporated by reference herein.

151. In any and all agreements and/or contracts entered into in which Plaintiffs were participants or intended third party beneficiaries individually or as a class, there is an implied covenant of good faith and fair dealing which requires that all parties to same must act in good faith and deal fairly with the other party in performing or enforcing the terms of the agreement and/or contract.

152. Each Defendant enterprise, by engaging inter alia in the unlawful naked short selling of counterfeit shares of Escala stock acted in bad faith, dishonestly or with improper motive to destroy or injure the right of Plaintiffs individually, or in their capacity as shareholders of Escala, to receive the benefits or reasonable expectation of their agreement or contract as third party beneficiaries.

153. Each Defendant enterprise, with no legitimate purpose: a) acted with bad motives or intentions; or b) engaged in deception or evasion in the performance of their agreement and/or contract; and by so doing denied Plaintiffs the benefit of the bargain as originally intended by the parties.

154. As a direct and proximate result of each Defendant enterprise's conduct, Plaintiffs have suffered damages.

WHEREFORE, Plaintiffs demand separate judgments against each Defendant enterprise, that is, Merrill Lynch, Pierce, Fenner & Smith, Inc., Knight Capital Americas, L.P., formerly known as Knight Equity Markets L.P., UBS Securities, L.L.C., E* Trade Capital Markets L.L.C., National Financial Services, L.L.C., Citadel Derivatives Group, L.L.C., John Does 1-10 (names being fictitious) and ABC Companies 1-10 (names being fictitious) for compensatory damages, attorney's fees, interest and costs of suit.

COUNT NINE
NEGLIGENCE

155. Plaintiffs repeat and realleges each and every allegation set forth in Paragraphs 1-154 of the Complaint as if incorporated by reference herein.

156. Each Defendant enterprise owed Plaintiffs a duty of care in their capacity as gatekeepers of the market.

157. Each Defendant enterprise, in engaging in conduct that fostered or facilitated the naked short sales of Escala stock breached the duty of care that they owed to the Plaintiffs to report suspicious transactions of naked short sales of the Escala stock in May 2006 and December 2006.

158. As a direct and proximate result of each Defendant enterprise's negligence, Plaintiffs have suffered damages.

WHEREFORE, Plaintiffs demand separate judgments against each Defendant enterprise, that

is, Merrill Lynch, Pierce, Fenner & Smith, Inc., Knight Capital Americas, L.P., formerly known as Knight Equity Markets L.P., UBS Securities, L.L.C., E* Trade Capital Markets L.L.C., National Financial Services, L.L.C., Citadel Derivatives Group, L.L.C., John Does 1-10 (names being fictitious) and ABC Companies 1-10 (names being fictitious) for compensatory damages, attorney's fees, interest and costs of suit.

COUNT TEN
PUNITIVE AND EXEMPLARY DAMAGES

159. Plaintiffs repeat and realleges each and every allegation set forth in Paragraphs 1-158 of the Complaint as if incorporated by reference herein.

160. Each Defendant enterprise's actions were undertaken willfully, wantonly and maliciously.

161. As a direct and proximate result of each Defendant enterprise's actions, Plaintiffs have suffered damages.

WHEREFORE, Plaintiffs demand separate judgments against each Defendant enterprise, that is, Merrill Lynch, Pierce, Fenner & Smith, Inc., Knight Capital Americas, L.P., formerly known as Knight Equity Markets L.P., UBS Securities, L.L.C., E* Trade Capital Markets L.L.C., National Financial Services, L.L.C., Citadel Derivatives Group, L.L.C., John Does 1-10 (names being fictitious) and ABC Companies 1-10 (names being fictitious) for punitive and exemplary damages, attorney's fees, interest and costs of suit.

NEAL H. FLASTER, L.L.C.
Attorneys for Plaintiffs Greg Manning, et al

By: */s/ Neal H. Flaster*
Neal H. Flaster

Dated: June 5, 2012

JURY DEMAND

Plaintiff demands a trial by jury on all issues so triable.

/s/ Neal H. Flaster
Neal H. Flaster

Dated: June 5, 2012

No. 14-1132

In the Supreme Court of the United States

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., ET AL.,
PETITIONERS,

v.

GREG MANNING, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE AND BRIEF FOR THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION AS AMICUS CURIAE SUPPORTING PETITIONERS

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MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE

Pursuant to Rule 37.2(b) of the Rules of this Court, the Securities Industry and Financial Markets Association (SIFMA) hereby respectfully moves for leave to file the accompanying brief as amicus curiae supporting petitioners in this case. SIFMA provided timely notice to the parties of its intent to file this brief. Petitioners have consented to filing; respondents' counsel has not responded to multiple inquiries.

The decision below deepens an existing circuit split regarding the meaning of Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. 78aa, which grants exclusive jurisdiction to federal courts over suits involving violations of the Exchange Act. Many of SIFMA's members are financial institutions subject to that Act, and they understand firsthand the need for clarity and uniformity in the application of the federal securities laws. As both regulated entities and litigants in this area, SIFMA's members are familiar with how the decision below will affect a significant sector of the financial industry and the U.S. securities market.

SIFMA respectfully submits that its views on the importance of this case shed additional light on the issues presented here and the need for this Court's review. In light of those views and its substantial interest in the resolution of this case, SIFMA requests that it be granted leave to participate as an amicus curiae by filing the accompanying brief in support of petitioners.

Respectfully submitted.

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APRIL 16, 2015

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BRIEF FOR THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION AS AMICUS CURIAE SUPPORTING PETITIONERS

INTEREST OF AMICUS CURIAE

SIFMA brings together the shared interests of more than 650 securities firms, banks, and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation, and economic growth, while building trust and confidence in the financial markets. With offices in New York and Washington, D.C., SIFMA is the U.S. regional member of the Global Financial Markets Association.[1]

SIFMA has a unique perspective on this case. Many of SIFMA's members are financial institutions subject to the Securities Exchange Act of 1934, 48 Stat. 881, 15 U.S.C. 78a *et seq.* This case concerns the interpretation of Section 27 of that Act, which grants exclusive jurisdiction to federal courts over Exchange Act violations. As both regulated entities and litigants in this area, SIFMA's members have a substantial interest in the meaning and scope of that provision. The decision below deepens an existing circuit split over the proper interpretation of Section

[1] Pursuant to Rule 37.6, SIFMA affirms that no counsel for a party authored this brief in whole or in part, and that no person other than amicus or its counsel contributed any money to fund its preparation or submission. SIFMA provided timely notice to the parties of its intent to file this brief. Petitioners have consented, but respondents' counsel has not responded to multiple inquiries. SIFMA therefore has filed a motion for leave to file this brief.

27, which has resulted in extensive litigation regarding the threshold question of where suits like this one should be brought. Accordingly, SIFMA has a significant interest in the Court's resolution of this case.

SUMMARY OF ARGUMENT

I. A. The courts of appeals are divided over the proper interpretation of Section 27. The Fifth and Ninth Circuits have held that Section 27 confers original jurisdiction over claims predicated on Exchange Act violations; the Second and now the Third Circuit have held that it does not. The difference is dispositive in a case like this one, because respondents have premised their state-law claims on violations of the Exchange Act and its implementing regulations. In other circuits, respondents' choice would invoke federal jurisdiction under Section 27. The resolution of that circuit conflict also stands to affect two other statutory regimes with similarly worded exclusive-jurisdiction provisions, the Natural Gas Act and the Federal Power Act, which likewise have given rise to conflicting decisions in the courts of appeals.

B. The question of Section 27's meaning and scope is both extremely important and frequently recurring. The four courts of appeals to address Section 27—the Second, Third, Fifth, and Ninth Circuits—are the most common fora for securities actions. The circuit conflict thus encourages forum-shopping by plaintiffs, who may bring their actions for enforcement of federal rules and regulations in state court by dressing up putative Exchange Act violations in the language of state law. Short selling is also a very common market practice that is the subject of increasing litigation. The division in the lower courts means that parties will continue to engage in protracted jurisdictional

litigation, with the avoidable expense that entails for litigants and the judiciary alike.

C. Although the proper interpretation of Section 27 is the subject of much litigation, those cases rarely reach this Court. In federal circuits (like the Second and Third) that do not interpret Section 27 as an independent grant of federal jurisdiction, orders granting remand in those cases are generally unreviewable by statute. In federal circuits (like the Fifth and Ninth) that do interpret Section 27 as an independent grant of federal jurisdiction, orders denying remand are generally unreviewable because of their interlocutory nature. This is the unusual case in which the district court denied remand but certified the jurisdictional issue for interlocutory review because the Third Circuit had yet to weigh in on the circuit conflict. There is no reason to expect that confluence of circumstances to recur anytime soon. Nor is there any reason to await further percolation in the lower courts. The conflict is longstanding, the issue is one of federal statutory interpretation, and the differing views have been briefed by the parties here and aired by the courts of appeals in this and other cases.

II. A. The decision below is inconsistent with Section 27's plain text, which provides that federal courts shall have "exclusive jurisdiction" over "violations" of the Act and over "*all* suits * * * brought to enforce *any* liability or duty created by [the Act] or the rules and regulations thereunder." 15 U.S.C. 78aa(a) (emphasis added). Congress could hardly have been clearer or used broader language. Suits that assert the violation of a federally imposed duty must be brought in federal court, even if plaintiffs nominally cloak their claims in state-law garb. Here, "[t]here is no question that [respondents] assert in their Amend-

ed Complaint, both expressly and by implication, that [petitioners] repeatedly violated federal law." Pet. App. 9a. Because plaintiffs have elected to premise their state-law claims on violations of the Exchange Act and its implementing regulations, there is federal jurisdiction over this case under Section 27.

B. The decision below is also inconsistent with the purpose of Section 27, which is "to achieve greater uniformity of construction and more effective and expert application of" the Exchange Act. *Matsushita Elec. Indus. Co., Ltd.* v. *Epstein*, 516 U.S. 367, 383 (1996). The decision below undercuts that purpose by permitting plaintiffs to plead around Section 27 in state court, meaning that state court judges will be called upon to interpret and enforce the Exchange Act. Market participants in turn will be forced to contend with interpretations of the Act issued by numerous state courts under a patchwork of many States' laws. All of that will undermine consistency in the rules governing trade settlement and clearing for securities transactions on the national exchanges. In light of the effects on financial markets, the need for uniform enforcement of Section 27, and the conflict among the lower courts on an important and recurring issue of federal statutory interpretation, this Court's review is warranted.

ARGUMENT

The decision below deepens a divide among the courts of appeals over the interpretation of Section 27 of the Exchange Act. That question is important and recurring, yet likely to evade this Court's review in future cases. The Court should therefore grant review in this case; provide clarity to litigants and lower courts; and reverse the decision below, which is at

odds with both Section 27's text and its aim of uniformity in the application of the Exchange Act.

I. THE QUESTION PRESENTED WARRANTS THIS COURT'S REVIEW IN THIS CASE.

A. The Courts Of Appeals Are Divided Over The Proper Interpretation Of Section 27 And Similar Exclusive-Jurisdiction Provisions.

1. As the petition explains (at 13-19), there is a conflict among the circuits over whether Section 27 confers federal jurisdiction for claims predicated on violations of the Exchange Act or its implementing regulations. The Fifth and Ninth Circuits have held that Section 27 is an independent grant of federal jurisdiction, and therefore may expand federal jurisdiction beyond that afforded by the general federal-question statute, 28 U.S.C. 1331. See, *e.g.*, *Hawkins* v. *Nat'l Ass'n of Sec. Dealers, Inc.*, 149 F.3d 330, 331-332 (5th Cir. 1998); *Sparta Surgical Corp.* v. *Nat'l Ass'n of Sec. Dealers, Inc.*, 159 F.3d 1209, 1212-1213 (9th Cir. 1998); *Sacks* v. *Dietrich*, 663 F.3d 1065, 1068-1069 (9th Cir. 2011).

In the decision below, the Third Circuit held to the contrary that Section 27 does not confer on federal courts any form of original jurisdiction over claims predicated on Exchange Act violations. See Pet. App. 22a (Section 27 "is coextensive" with Section 1331, "merely serves to divest state courts of jurisdiction," and "does not provide an independent basis to exercise jurisdiction."). The Third Circuit acknowledged that its decision is at odds with those of the Fifth and Ninth Circuits, but the court elected to side instead with the Second Circuit's decision in *Barbara* v. *N.Y. Stock Exch.*, 99 F.3d 49 (1996), which held that Section 27 reaches only suits that are expressly brought

under the Exchange Act (and thus that arise under federal law for purposes of Section 1331), see *id.* at 55. See Pet. App. 22a.[2]

2. As the petition also explains (at 17-19), the resolution of the question presented will affect two other federal statutory regimes. Both the Natural Gas Act, 15 U.S.C. 717u, and the Federal Power Act, 16 U.S.C. 825p, contain exclusive-jurisdiction provisions that are nearly identical to Section 27. The Sixth Circuit has held that the former does not provide an independent basis for federal jurisdiction, see *Columbia Gas Transmission, LLC* v. *Singh*, 707 F.3d 583, 591 (2013), whereas the Ninth Circuit has held that the latter does provide such a basis, see *Cal. ex rel. Lockyer* v. *Dynegy*, 375 F.3d 831, 843 (2004). The question presented thus has significant "ramifications beyond the instant case." *Bartlett* v. *Stephenson*, 535 U.S. 1301, 1304 (2002).

B. The Question Of Section 27's Scope Is Important And Recurring.

1. The Circuit Conflict Encourages Forum-Shopping.

The divide among the Second and Third Circuits on the one hand, and the Fifth and Ninth Circuits on the other, is particularly important because those four

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[2] In recent years, the Second Circuit has avoided revisiting *Barbara* by construing federal-question jurisdiction broadly under Section 1331. See *NASDAQ OMX Group, Inc.* v. *UBS Sec., LLC*, 770 F.3d 1010, 1030 (2d Cir. 2014); *D'Alessio* v. *N.Y. Stock Exch., Inc.*, 258 F.3d 93, 101-102 (2d Cir. 2001). *Barbara* remains the law in the Second Circuit, however, and the Third Circuit did not construe Section 1331 broadly in the decision below. As a result, there is a square conflict over the question presented.

courts are the most common fora for securities actions. *Cf.* Cornerstone Research, *Securities Class Action Filings: 2014 Year in Review* 25 (2015) (noting that last year 126 of 170, or roughly three-quarters of, securities class actions were filed in the Second, Third, Fifth, and Ninth Circuits). The circuit conflict both enables and encourages forum-shopping by plaintiffs, who will bring their actions for enforcement of *federal* rules and regulations in *state* court by dressing up federal violations in the language of state law. Plaintiffs thus may invoke federal substantive standards while simultaneously staving off federal jurisdiction. That result is precisely what an *exclusive*-jurisdiction provision like Section 27 is meant to avoid. See, *e.g.*, *Heller, Ehrman, White & MacAuliffe* v. *Babbitt*, 992 F.2d 360, 363 (D.C. Cir. 1993) (Plaintiffs "may not, by creatively framing their complaint, circumvent a congressional grant of exclusive jurisdiction.").

2. Short Selling Is A Common Market Practice That Is The Subject Of Increasing Litigation.

Respondents' complaint asserts that petitioners violated Regulation SHO, 17 C.F.R. 242.200 *et seq.*, the regulation promulgated by the Securities and Exchange Commission to govern short sales of equity securities. See Pet. App. 8a; see also Short Sales, SEC Release No. 34-50103, 69 Fed. Reg. 48,008 (Aug. 6, 2004). The question of whether a suit like this one belongs in federal or state court arises with increasing frequency, both because of the important role that short selling plays in securities markets and because of the rising number of lawsuits that allege unlawful naked short selling. See Christopher L. Culp & J.B.

Heaton, *The Economics of Naked Short Selling*, Regulation 47 (Spring 2008) ("Naked short selling has been the focus of an increasing number of lawsuits.").

Short selling involves "a sale of a security that the seller does not own or that is consummated by the delivery of a security borrowed by or on behalf of the seller." "Naked" Short Selling Antifraud Rule, SEC Release No. 34-58774, 73 Fed. Reg. 61,666, 61,667 (Oct. 17, 2008). So-called "naked" short selling occurs when "the seller does not borrow or arrange to borrow the securities in time to make delivery to the buyer within the standard three-day settlement period." U.S. Securities and Exchange Commission, Division of Market Regulation, *Key Points About Regulation SHO* (Apr. 8, 2015). To address concerns associated with abusive naked short selling, the Commission promulgated Regulation SHO, which places certain restrictions on naked short selling. See Christopher M. Salter & Christopher F. Chase, *Short Selling and Naked Shorts in the Regulation SHO Environment*, Rev. Sec. & Commodities Reg. 2-3 (Nov. 21, 2007).

Those restrictions affect a wide variety of market participants, including those that engage in short selling as well as their brokers. See, *e.g.*, U.K. Financial Services Authority, *Discussion Paper no. 09/1—Short Selling* 7-8 (2009) (observing that short selling is a trading strategy frequently used by market makers and investment banks, as well as "traditional fund managers such as pension funds and insurance companies"). Indeed, for some market participants, short selling constitutes a significant portion or even the entirety of their trading strategy. See *Key Points About Regulation SHO* (explaining that many firms employ a short selling strategy). That market segment is critical because, as the SEC has observed,

short selling provides "important benefits" to the market, including "market liquidity and pricing efficiency." Short Sales, SEC Release No. 34-48709, 68 Fed. Reg. 62,972, 62,974 (Nov. 6, 2003); see International Organization of Securities Commissions, *Regulation of Short Selling—Consultation Report* 5 (2009).

In light of the role that short selling plays in the market, it is hardly surprising that short sellers, clearing brokers, and courts have seen an uptick in suits alleging violations of Regulation SHO. Nor is it surprising that, because several courts of appeals have construed Section 27 differently, there will continue to be litigation in other circuits over where to litigate, expending the resources of parties and the judiciary alike. See *Bowen* v. *Massachusetts*, 487 U.S. 879, 930 (1988) (Scalia, J., dissenting) ("Nothing is more wasteful than litigation about where to litigate."). This Court should take this opportunity to put an end to that jurisdictional wrangling, provide clarity to a substantial segment of the securities markets, and resolve whether Section 27 confers original federal jurisdiction over claims predicated on violations of the Exchange Act or regulations promulgated thereunder (such as Regulation SHO).

C. The Question Often Evades This Court's Review.

When plaintiffs allege violations of the Exchange Act or its implementing regulations as the predicates for state-law liability, most of those cases never reach this Court. In federal circuits (like the Second and Third) that do not interpret Section 27 as an independent grant of federal jurisdiction, orders granting remand in those cases are generally unreviewable by

statute. See 28 U.S.C. 1447(d). In federal circuits (like the Fifth and Ninth) that do interpret Section 27 as an independent grant of federal jurisdiction, orders denying remand are generally unreviewable because of their interlocutory posture. See, *e.g.*, *Melancon* v. *Texaco, Inc.*, 659 F.2d 551, 552-553 (5th Cir. 1981) ("[A]n order denying remand of a case removed to federal court is not a final order * * * [and] cannot be appealed unless certified by the district court in accordance with 28 U.S.C. § 1292(b)."); *Bishop ex rel. Bishop* v. *Bechtel Power Corp.*, 905 F.2d 1272, 1275 (9th Cir. 1990) (noting the "interlocutory nature of orders denying remand").

This is the unusual case in which (i) the district court denied the motion to remand but (ii) certified the jurisdictional issue for interlocutory review under 28 U.S.C. 1292(b) because (iii) the Third Circuit had yet to weigh in on the circuit split. That confluence of circumstances is not apt to recur anytime soon. As explained above, the vast bulk of securities cases are filed in the four circuits (the Second, Third, Fifth, and Ninth) that already have addressed the question. And even in other circuits, interlocutory appeals are rare. See, *e.g.*, *In re San Juan Dupont Plaza Hotel Fire Litig.*, 859 F.2d 1007, 1010 n.1 (1st Cir. 1988) (observing that "only rare cases will qualify" for interlocutory appeal under Section 1292(b)). There is thus no reason to await further and likely futile percolation in the lower courts. The Court's review is warranted now: the conflict is longstanding, the issue is one of federal statutory interpretation, and the differing views have been fully briefed by the parties here and aired by the courts of appeals in this and other cases.

II. THE THIRD CIRCUIT'S INTERPRETATION IS INCONSISTENT WITH THE TEXT AND PURPOSE OF SECTION 27.

A. The Decision Below Is At Odds With Section 27's Plain Text.

1. Respondents' complaint repeatedly and expressly references federal law, in addition to incorporating standards of conduct located exclusively in federal regulations. See, *e.g.*, Pet. App. 44a, 49a, 51a, 52a-54a, 55a, 59a. As both the court of appeals and the district court therefore recognized, "[t]here is no question that [respondents] assert in their Amended Complaint, both expressly and by implication, that [petitioners] repeatedly violated federal law." *Id.* at 9a; see *id.* at 29a ("Notably, [respondents] do not dispute that the alleged unlawful conduct is predicated on a violation of Regulation SHO, 17 C.F.R. § 242.204.").

Respondents' own allegations should end the jurisdictional analysis. Section 27 of the Exchange Act vests federal courts with "exclusive jurisdiction of (1) violations of [the Act] or the rules and regulations thereunder, and of (2) all suits . . . brought to enforce any liability or duty created by [the Act] or the rules and regulations thereunder." 15 U.S.C. 78aa(a) (numbering added). The present suit is brought to "enforce" a "duty" created by a regulation promulgated under the Exchange Act (Regulation SHO), even if the mechanism for enforcing that duty is a state-law cause of action that incorporates the federal standard. The court of appeals effectively read Section 27's second clause to apply only to suits that arise under the Exchange Act for purposes of federal-question jurisdiction pursuant to 28 U.S.C. 1331. But the language

of Section 27 is much broader: it extends to "all suits" intended to enforce federal duties created by the Exchange Act or its implementing regulations, regardless of whether those suits are pleaded under federal or state law.

Even if this Court were inclined to read Section 27's second clause narrowly, that still would not justify the court of appeals' ruling. Congress also provided jurisdiction over all "*violations*" of the Act and its implementing regulations. 15 U.S.C. 78aa(a) (emphasis added). That language is not limited to criminal violations. Indeed, with respect to venue, Section 27 uses the term "violation" to refer not only to criminal proceedings, but also to civil actions for injunctive relief. See *id.* (providing for venue in "[a]ny suit or action * * * to enjoin any violation" of the Exchange Act or its implementing regulations). By its terms, the first clause of Section 27—the violations clause—extends to suits that, although not pleaded under the Exchange Act, are predicated on alleged violations of the Act.

2. The court of appeals did not address the text of Section 27, holding instead that its ruling was controlled by this Court's decision in *Pan American Petroleum Corp.* v. *Superior Court of Delaware*, 366 U.S. 656 (1961) (*Pan American*). See Pet. App. 19a-20a. But *Pan American* was fundamentally a contract case. There, a pipeline company paid more for natural gas than its contracts required because of a pending state regulatory order. The company notified its suppliers that it had challenged the order and that it expected repayment in the event the order was lifted—a condition to which the suppliers did not object. See 366 U.S. at 658-659. When this Court set aside the order, the pipeline company brought suit on

its contracts in state court, but the suppliers claimed that the case had to be heard in federal court in part because of the exclusive-jurisdiction provision in the Natural Gas Act (NGA). See *id.* at 660.

This Court disagreed for the obvious reason that although the plaintiff in *Pan American* could have pursued a federal filed-rate claim under the NGA, it had elected to pursue solely a contract claim, to which federal issues could arise only by way of a defense. See 366 U.S. at 663. In a very real sense, the plaintiff in *Pan American* was not invoking federal law, either formally or functionally. Here, by contrast, respondents do not have an independent, freestanding state-law claim. Only by invoking federal standards of conduct (namely, Regulation SHO) do they manage to assert a claim at all. Indeed, their complaint repeatedly borrows the language of, and directly refers to, Regulation SHO. As masters of their own complaint, respondents have elected to allege violations of the Exchange Act and Regulation SHO, and that conscious choice brings them squarely within the ambit of Section 27.

To be sure, the Court in *Pan American* recited the truism that exclusive jurisdiction is "'exclusive' only for suits that may be brought in the federal courts. Exclusiveness is a consequence of having jurisdiction, not the generator of jurisdiction." 366 U.S. at 664. But no one here contends that the term "exclusive" in Section 27 is what generates jurisdiction. What creates federal jurisdiction is the language that *follows* the term "exclusive," *i.e.*, the language defining the scope of federal jurisdiction over all violations of, and all suits brought to enforce, the Act and its implementing regulations. Moreover, although *Pan American* states in passing in a footnote that the NGA's ex-

clusive-jurisdiction provision is limited to cases "arising under" the NGA, *id.* at 665 n.2, the Court based that dictum not on the provision's text, but on its legislative history.[3] That does not warrant ignoring the plain text of Section 27 in this context.

B. The Decision Below Is At Odds With Section 27's Purpose Of Achieving Uniformity In The Application Of The Exchange Act.

1. The purpose of Section 27 is "to achieve greater uniformity of construction and more effective and expert application of" the Exchange Act and its implementing regulations. *Matsushita Elec. Indus. Co., Ltd.* v. *Epstein*, 516 U.S. 367, 383 (1996) (*Matsushita*). The decision below unquestionably undermines that purpose. It allows plaintiffs to plead around Section 27 in state court, thus posing the very real "danger that state court judges who are not fully expert in federal securities law will say definitively what the Exchange Act means and enforce legal liabilities and duties thereunder." *Ibid.*; see Barry Friedman, *Under the Law of Federal Jurisdiction: Allocating Cases Between Federal and State Courts*, 104 Colum. L. Rev. 1211, 1241 (2004) (noting that state court adjudication of federal law tends to create disuniformity).

Indeed, the very point of Section 27's grant of exclusive federal jurisdiction is to ensure that "binding legal determinations of rights and liabilities under the

---

[3] The NGA's legislative history specified that the exclusive-jurisdiction provision there governs "cases arising under the act." S. Rep. No. 1162, 75th Cong., 1st Sess. 7 (1937); *see* H. Rep. No. 709, 75th Cong., 1st Sess. 9 (1937) (same). There is no analogous legislative history for Section 27. See *Matsushita*, 516 U.S. at 383.

Exchange Act are for *federal courts only*." *Matsushita*, 516 U.S. at 384 (emphasis added). By creating exclusive federal jurisdiction, Congress furthered its interest in a "nationally uniform interpretation." *Reed* v. *Farley*, 512 U.S. 339, 348-349 (1994); see *Gulf Offshore Co.* v. *Mobil Oil Corp.*, 453 U.S. 473, 483-484 (1981) (observing that "desirability of uniform interpretation" is an interest advanced by a grant of exclusive federal jurisdiction); see also *Grable & Sons Metal Prods., Inc.* v. *Darue Eng'g & Mfg.*, 545 U.S. 308, 312 (2005) (acknowledging "the experience, solicitude, and hope of uniformity that a federal forum offers on federal issues").

2. Uniformity in the interpretation of Section 27 is particularly important because of the need for predictability in the financial markets. See *Pinter* v. *Dahl*, 486 U.S. 622, 652 (1988) (noting that the securities laws are "an area that demands certainty and predictability"). As matters currently stand, market participants face uncertainty not only with respect to *where* they may be compelled to defend against securities claims, but also with respect to *what* their duties and responsibilities will be under the federal securities laws. The practical reality is that market participants may be forced to comply with interpretations of the Exchange Act issued by numerous state courts under a patchwork of many States' laws—making it more difficult to ascertain what conduct does and does not run afoul of federal securities laws. That defeats Section 27's purpose of achieving consistency in the rules governing trade settlement and clearing for securities transactions on the national exchanges.

The "ripple effects" of uncertainty are magnified here because short sales are very common transactions in which many market participants engage. See

Cent. Bank of Denver, N.A. v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 189 (1994). The decision below thus stands to have a significant effect on financial markets. As claims concerning Regulation SHO are litigated in state courts, there will be a corresponding increase in "legal uncertainty for firms about whether activity that is lawful under the federal regulatory scheme may nevertheless be questioned in state court," which in turn "may cause firms to impose restrictions on customer short sale activity and limit proprietary short sale activity," thereby "reduc[ing] liquidity" and "harm[ing] the markets by making price discovery less efficient." Salter & Chase, *supra*, at 7. In light of those consequences, the "need for uniform enforcement" of Section 27, and the "conflict among the lower courts on [an] important and recurring issue," this Court's review is warranted. *California* v. *Am. Stores Co.*, 492 U.S. 1301, 1306 (1989).

CONCLUSION

For the reasons set forth above, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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APRIL 16, 2015

SUPREME COURT, U.S.
FILED
JUN - 5 2015
OFFICE OF THE CLERK

No. 14-1132

IN THE

Supreme Court of the United States

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.; KNIGHT CAPITAL AMERICAS L.P., FORMERLY KNOWN AS KNIGHT EQUITY MARKETS L.P.; UBS SECURITIES LLC; E*TRADE CAPITAL MARKETS LLC; NATIONAL FINANCIAL SERVICES LLC; AND CITADEL DERIVATIVES GROUP LLC,
Petitioners,

v.

GREG MANNING; CLAES ARNRUP; POSILJONEN AB; POSILJONEN AS; SVEABORG HANDEL AS; FLYGEXPO AB; AND LONDRINA HOLDING LTD.,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

According to the Petition, this case presents the following question: "[w]hether § 27 of the Securities Exchange Act of 1934 provides federal jurisdiction over state-law claims seeking to establish liability based on violations of the Act or its regulations or seeking to enforce duties created by the Act or its regulations." Pet. i. That formulation, however, is grossly misleading.

An essential premise of the Petition is that the Third Circuit "held that respondents' claims, while framed as state-law causes of action, are based on alleged violations of, and seek to enforce duties created by, the SEC's Regulation SHO . . . ." Pet. 3. But that premise is demonstrably false. Indeed, the Third Circuit expressly noted: "As we read the Amended Complaint, no causes of action are predicated *at all* on a violation of Regulation SHO." Pet. App. 14a (emphasis in original).

As such, this case presents the following questions:

1. Did the Third Circuit err in finding that "As we read the Amended Complaint, no causes of action are predicated *at all* on a violation of Regulation SHO." Pet. App. 14a (the "Antecedent Fact Question")?

2. If so, did the Third Circuit also err in holding "that § 27 [of the Exchange Act] is coextensive with [28 U.S.C.] § 1331 for purposes of establishing subject-matter jurisdiction" Pet. App. 22a (the "Petition Question")?

RULE 29.6 STATEMENT

Posiljonen AB has no parent corporation, and no publicly held corporation owns 10% or more of Posiljonen AB's stock.

Posiljonen AS has no parent corporation, and no publicly held corporation owns 10% or more of Posiljonen AS's stock.

Sveaborg Handel AS has no parent corporation, and no publicly held corporation owns 10% or more of Sveaborg Handel AS's stock.

Flygexpo AB has no parent corporation, and no publicly held corporation owns 10% or more of Flygexpo AB's stock.

Londrina Holding Ltd. has no parent corporation, and no publicly held corporation owns 10% or more of Londrina Holding Ltd.'s stock.

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COUNTERSTATEMENT OF THE CASE

I. Statutory Background

States have regulated the public securities markets since their inception. *See generally* James Burk, *Values in the Marketplace: The American Stock Market Under Federal Securities Law* 169 (1998) (Table: C.2: Major Actions by Various States to Regulate Securities Business, 1852-1921) (describing state efforts); Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 Tex. L. Rev. 347, 352-64 (1991) (discussing impetus behind state "blue sky laws" regulating securities transactions during early twentieth century).

Early state statutes included specific disclosure requirements and prohibitions on fraud and misrepresentation.[1] These statutes survived numerous federal constitutional challenges on the grounds that they were legitimate exercises of the states' police power. As the Supreme Court explained in upholding a Michigan statute:

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[1] *See, e.g.*, Act of Mar. 10, 1911, ch. 133, 1911 Kan. Sess. Laws 210; Act of May 18, 1912, ch. 69, 1912 Ariz. Sess. Laws 338; Act of Feb. 13, 1913, No. 170, 1912 Vt. Laws 196; Act of July 1, 1912, No. 40, 1912 La. Acts 47; Arkansas Securities Act, No. 214, 1913 Ark. Acts 904; Idaho Securities Act, 1913 Idaho Sess. Laws 454; Act of May 2, 1913, No. 143, 1913 Mich. Pub. Acts 243; Act of Mar. 13, 1913, ch. 85, 1913 Mont. Laws 367; Supervision of Investment Companies, ch. 109, 1913 N.D. Laws 137; Act of Apr. 28, 1913, § 16, 1913 Ohio Laws 743, 751-52; Act of Apr. 7, 1913, C.S.S.B. 78 and 79, 1913 Mo. Laws 112; Act of Apr. 9, 1913, ch. 209, 1913 Me. Laws 291; Act of Aug. 19, 1913, No. 263, 1913 Ga. Laws 117; Act of Apr. 19, 1913, ch. 137, 1913 Iowa Laws 137; Act of Apr. 21, 1913, ch. 199, 1913 Neb. Laws 603; Act of Mar. 12, 1913, ch. 156, 1913 N.C. Sess. Laws 249; Act of Feb. 28, 1913, ch. 341, 1913 Or. Gen. Laws 668; Act of Aug. 21, 1913, ch. 32, 1913 Tex. Gen. Laws 66; Act of Aug. 21, 1913, ch. 756, 1913 Wis. Laws 1108.

> [W]e think the statute under review is within the power of the state. It burdens honest business, it is true, but burdens it only that, under its forms, dishonest business may not be done.

Merrick v. Halsey & Co., 242 U.S. 568, 587 (1917). *See also Hall v. Geiger-Jones Co.*, 242 U.S. 539, 551 (1917) ("[W]e shall not pause to do more than state that the prevention of deception is within the competency of government . . . .").

When Congress enacted federal securities laws, it expressly contemplated an ongoing role for the states. Both the Securities Act of 1933, 15 U.S.C. § 77a *et seq.* (the "Securities Act"), and the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* (the "Exchange Act"), left the existing state regulatory schemes intact. *See, e.g.*, 15 U.S.C. § 77r; 15 U.S.C. § 78bb. And with the exception of the Exchange Act, every major piece of federal securities legislation has provided for concurrent jurisdiction over federal securities laws. Securities Act of 1933 § 22(a), 15 U.S.C. § 77v(a); Investment Company Act of 1940 § 44, 15 U.S.C. § 80a-43; Investment Advisers Act of 1940 § 214, 15 U.S.C. § 80b-14.

That dual state-federal regulatory regime continues to this day. *See Flaxel v. Johnson*, 541 F. Supp. 2d 1127, 1144 (S.D. Cal. 2008) ("Although Congress has prohibited the states from regulating the registration of certain classes of securities, states may continue to regulate the sale of securities through statutory and common-law causes of action for securities fraud.") (citing *Matsushita Elec. Indus. Co., Ltd. v. Epstein*, 516 U.S. 367, 383-84 (1996) ("Congress plainly contemplated the possibility of dual litigation in state and federal courts relating to

securities transactions.")); *Diamond Multimedia Sys., Inc. v. Super. Ct.*, 968 P.2d 539, 552 (Cal. 1999) ("The Securities Exchange Act of 1934 makes it clear that . . . federal law in this arena supplements, but does not displace state regulation and remedies"); *Zuri-Invest AG v. Natwest Fin. Inc.*, 177 F. Supp. 2d 189, 191 (S.D.N.Y. 2001) (denying motion for partial summary judgment of common-law fraud claim on preemption grounds).

A. Relevant New Jersey law

The operative complaint in this case (the "Amended Complaint" or "AC"), seeks relief *exclusively* under the statutory and common law of New Jersey. Pet. App. 41a-102a (AC ¶¶ 1-161). *See also infra* 9 (discussing claims asserted in Amended Complaint).

1. For over 150 years, New Jersey investors have relied on state common law for protection against manipulation of the securities markets. *See, e.g., Morris Canal & Banking Co. v. Fisher*, 9 N.J. Eq. 667 (N.J. 1855) (addressing negotiability of bonds allegedly issued without stockholder authorization). Such is still the case today. *See, e.g., Prudential Ins. Co. of Am. v. Bank of Am., Nat'l Ass'n*, 14 F. Supp. 3d 591 (D.N.J. 2014) (addressing allegations of fraud and negligent misrepresentation regarding underwriting guidelines for residential mortgage backed securities).

2. Like many other states, New Jersey sought to heighten the common law protections for investors in the twentieth century. New Jersey adopted a version of the Uniform Securities Act in 1967 and amended it in 1997. *See* Uniform Securities Law (1997), N.J. Rev. Stat.

§ 49:3-47 *et seq.* ("NJUSL").[2] As amended, NJUSL provides:

> It shall be unlawful for any person, in connection with the offer, sale, or purchase of any security, directly or indirectly
>
> (a) To employ any device, scheme, or artifice to defraud;
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading;
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person . . . .

N.J. Rev. Stat. § 49:3-52.

NJUSL also specifically prohibits any person from quoting a fictitious price for a security, effectuating certain transactions "for the purpose of creating a false or misleading appearance of active trading in a security or with respect to the market for the security," or "employ[ing] any other deceptive or fraudulent device,

---

[2] In 1956, various states undertook to bring uniformity to their regulatory schemes. The National Conference of Commissioners on Uniform State Laws approved the Uniform Securities Act that year. Uniform Securities Act (1956) (amended 1958). Thirty-six states and the District of Columbia eventually adopted a version of the Uniform Securities Act. 1 Blue Sky L. Rep. (CCH) § 5501 (1985); *see generally* Aaron D. Rachelson, *Corporate Acquisitions, Mergers, and Divestitures* § 4:79 (2013).

scheme, or artifice to manipulate the market in a security." N.J. Rev. Stat. § 49:3-52.1.

NJUSL defines the terms "fraud," "deceit,"" and "defraud" to include "[g]enerally any course of conduct or business which is calculated or put forward with intent to deceive the public or the purchaser of any security or investment advisory services as to the nature of any transaction or the value of any such security." N.J. Rev. Stat. § 49:3-49(2)(e); *see also id.* ("'Fraud,' 'deceit,' and 'defraud' are not limited to common-law fraud or deceit.").

3. In 1981, the New Jersey legislature enacted the New Jersey Racketeering Influenced and Corrupt Organization Act, N.J. Rev. Stat. § 2C:41 *et seq.* ("NJRICO"). The goal of NJRICO was "to provide that activity which is inimical to the general health, welfare and prosperity of the State and its inhabitants be made subject to strict civil and criminal sanctions." N.J. Rev. Stat. § 2C:41-1.1. The statute contains a liberal construction provision. N.J. Rev. Stat. § 2C:41-6. And predicate acts of racketeering under NJRICO include violations of NJUSL. *See* N.J. Rev. Stat. § 2C:41-1(a) ("'Racketeering activity' means (1) any of the following crimes which are crimes under the laws of New Jersey . . . (p) fraud in the offering, sale or purchase of securities . . . .").

New Jersey courts have interpreted NJRICO consistent with the sweeping intent of the legislature. *See, e.g., State v. Ball*, 661 A.2d 251, 258-59 (N.J. 1995) ("[T]he Legislature decided not to limit the statute's application only to such traditional organized crime interests as the Mafia."); *see generally* John E. Floyd,

RICO State by State: A Guide to Litigation Under the State Racketeering Statutes 520 (1998).

B. Relevant federal law

Although the Amended Complaint seeks relief *only* under New Jersey law, its factual allegations—if proven—would also constitute violations of federal law.

1. Section 10(b) of the Exchange Act and Rule 10b-5 are the principal antifraud provisions in the federal securities regime. Section 10(b) of the Exchange Act generally prohibits, among other things, the use of "any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe" in connection with the purchase or sale of securities. 15 U.S.C. § 78j(b). Rule 10b-5 specifically prohibits fraud and misrepresentation in connection with the purchase or sale of any security. *See* 17 C.F.R. § 240.10b-5.

2. In 2004, the Securities and Exchange Commission ("SEC") adopted Regulation SHO pursuant to the Exchange Act to curb a practice called "naked short-selling." *See* 17 C.F.R. § 242.200 *et seq.*; Short Sales, SEC Release No. 34-50103, 69 Fed. Reg. 48,008 (Aug. 6, 2004) (codified at 17 C.F.R. pts. 240, 241 and 242) ("Regulation SHO Release").

"'Short-selling' is the practice of borrowing shares of stock, selling them and seeking to repurchase those shares at a lower price, returning the lower-priced shares to the lender and keeping the difference as profit." *Fairfax Fin. Holdings. Ltd. v. S.A.C. Capital Mgmt., LLC*, Civ. No. 06-4197, 2007 WL 1456204, at *1 (D.N.J. May 15, 2007). Short-selling is generally legal despite its risks. *See, e.g.*, Regulation SHO Release at

48,009 n.6 (recognizing that short-selling can be a "tool for driving the market down" and for "accelerating a declining market") (citing Short Sales of Securities, SEC Release No. 34-13091 (Dec. 21, 1976), 41 Fed. Reg. 56,530 (Dec. 28, 1976)).

"'Naked short-selling' occurs when traders sell shares they do not own or borrow, or ever intend to own, and never deliver the 'borrowed' securities that they sell." Report and Recommendation, ECF No. 36, at 2-3 (citing *Avenius v. Banc of Am. Sec. LLC*, Civ. No. 06-4458, 2006 WL 4008711, at *1 (N.D. Cal. Dec. 30, 2006); *Capece v. DTCC*, Civ. No. 05-80498, 2005 WL 4050118, at *3 (S.D. Fla. Oct. 11, 2005)).

Naked short-selling is often abusive. *See, e.g.*, "Naked" Short Selling Antifraud Rule, SEC Release No. 34-57511, 73 Fed. Reg. 61,666, 61,674 (Oct. 17, 2008) (codified at 17 C.F.R. pt. 240) ("Anti-Fraud Release") ("[F]ails to deliver might be indicative of manipulative 'naked' short selling, which could be used as a tool to drive down a company's stock price . . . ."); CAPT Luncheon, Chairman Harvey Pitt, at 6 (Nov. 16, 2007), *available at* http://www.financialsensearchive.com/fsn/2007/HarveyPitt.pdf ("Phantom shares created by naked short selling are analogous to counterfeit money."). Issuers targeted by naked short-sellers risk losing investor confidence and the ability to raise capital altogether. *See generally* Anti-Fraud Release.

Regulation SHO requires a broker-dealer to have "reasonable grounds" to believe that a security can be borrowed and delivered to the buyer within three days following the trade date before executing a short sale order. 17 C.F.R. § 242.203(b)(1) ("Locate Requirement"). If the short seller fails to deliver the securities for an

extended period, then the broker-dealer may be required to purchase and deliver securities "of like kind and quantity." 17 C.F.R. § 242.203(b)(3) ("Close Out Requirement").

Although there is no specific private right of action to remedy a violation of Regulation SHO, the SEC has advised that such a violation may constitute civilly actionable securities fraud prohibited by Section 10(b) of the Exchange Act. *See* Office of Investor Educ. and Advocacy, SEC, Key Points About Regulation SHO, http://www.sec.gov/investor/pubs/regsho.htm (last modified Apr. 8, 2015) ("Those who deceive about their intention or ability to deliver securities in time for settlement are committing fraud . . . when they fail to deliver securities by the settlement date."); *id.* ("Selling stock short and failing to deliver shares at the time of settlement with the purpose of driving down the security's price . . . would violate various securities laws, including Rule 10b-5 under the Exchange Act.").

II. Procedural History

This lawsuit involves Escala, Inc. ("Escala"), a company whose market capitalization plummeted nearly $800 million in just eleven months. Plaintiff's Reply, ECF No. 30, at 7 n.8. Plaintiffs are former shareholders of Escala including Gregory Manning, Escala's founder and former CEO. Pet. App. 45a-46a (AC ¶¶ 7-13). Defendants are several large financial institutions whose participation in the naked-short selling of Escala common stock, according to Plaintiffs, diluted their voting rights and caused their shares to decline precipitously in value. Pet. App. 46a-47a (AC ¶¶ 14-20). What follows is a brief summary of the relevant procedural history of this litigation.

1. Plaintiffs sued Defendants in the Superior Court of New Jersey, Law Division, Morris County on May 8, 2012. Pet. App. 26a. Plaintiff Gregory Manning, the owner of approximately 2.1 million shares of Escala stock during the relevant period, lives in Morris County, Pet. App. 45a (AC ¶ 7), which neighbors Escala's principal place of business Essex County, Pet. App. 48a (AC ¶ 22). Plaintiffs filed the Amended Complaint on June 7, 2012. Pet. App. 26a.

The Amended Complaint asserts ten causes of action under New Jersey law: (1) violation of NJRICO § 2C:41-2(c), Pet. App. 82a-90a (AC ¶¶ 88-113); (2) violation of NJRICO § 2C:41-2(a), Pet. App. 91a-93a (AC ¶¶ 114-22); (3) unjust enrichment, Pet. App. 93a-94a (AC ¶¶ 123-27); (4) unlawful interference with prospective economic advantage, Pet. App. 94a-95a (AC ¶¶ 128-33); (5) tortious interference with contractual relations, Pet. App. 95a-97a (AC ¶¶ 134-40); (6) unlawful interference with contractual relations, Pet. App. 97a-98a (AC ¶¶ 141-45); (7) third party beneficiary claims, Pet. App. 98a-99a (AC ¶¶ 146-49); (8) breach of the covenant of good faith and fair dealing, Pet. App. 99a-100a (AC ¶¶ 150-54); (9) negligence, Pet. App. 100a-01a (AC ¶¶ 155-58); and (10) punitive and exemplary damages, Pet App. 101a (AC ¶¶ 159-61). It alleges that Defendants committed three predicate acts of racketeering activity under NJRICO: (1) willful violations of NJUSL, Pet. App. 84a-87a (AC ¶¶ 96-101); (2) theft by taking, Pet App. 87a-89a (AC ¶¶ 102-07); and (3) theft by deception, Pet. App. 89a-90a (AC ¶¶ 108-13).

The Amended Complaint acknowledges that Defendants' market manipulation *also* violated federal law. *See, e.g.*, Pet. App. 75a-82a (AC ¶¶ 81-87) (discussing pattern of unlawful behavior and history of federal

enforcement). It explicitly does not, however, assert any federal causes of action. *See* Pet. App. 82a-101a (AC ¶¶ 88-161). And it does not allege that Defendants' violations of Regulation SHO were predicate acts for any state law cause of action.

2. Defendant Merrill Lynch, Pierce, Fenner & Smith ("Merrill") filed a Notice of Removal on July 17, 2012. Pet. App. 26a. Defendants contended that removal was proper because (1) the claims in the Amended Complaint "arise under" federal law and therefore confer federal question jurisdiction pursuant to 28 U.S.C. § 1331, and (2) the federal district court was vested with exclusive jurisdiction under § 27 of the Exchange Act.

Plaintiffs moved to remand on August 16, 2012. Pet. App. 26a. According to Plaintiffs, there was no "arising under" jurisdiction under 28 U.S.C. § 1331 because Plaintiffs could establish each of their state law claims without reference to federal law. *See, e.g.*, Motion to Remand, ECF No. 11-2, at 16 ("Here, Plaintiffs can prevail . . . without relying on or proving a violation of federal law by demonstrating that Defendants engaged in deceptive conduct in never intending to make delivery of the shorted Escala stock."); Plaintiffs' Reply, ECF No. 30, at 2 ("It is the intent and effect of Defendant[s'] wrongful conduct that serves as the measure of liability for Defendants' violation of state RICO and other common law claims, not the violation of any federal regulation or rule.").

Plaintiffs also explained that the exclusive jurisdiction provision in § 27 of the Exchange Act does not apply because Plaintiffs sought to vindicate only their rights under New Jersey law:

> Because Plaintiffs' claims arise out of *state* law rights and duties, Plaintiffs have *state* law rights to be free from fraud, misrepresentation, and material omissions in the sale of securities, *state* law rights to be free from market manipulation and *state* law rights to be free from deceit and theft. . . . [New Jersey] provide[s] claims for relief from abuses in the securities field independent of and in addition to federal claims for relief . . . .

Motion to Remand, ECF No. 11-2, at 16-17 (emphasis in original).

3. Recognizing that none of Plaintiffs' claims is predicated on an alleged violation of federal law, the federal magistrate judge recommended remand on December 31, 2012. Pet. App. 9a (Third Circuit discussing Magistrate Judge's Report and Recommendation).

First, the magistrate rejected Defendants' argument that there is "arising under" jurisdiction. *See* Report and Recommendation, ECF No. 36, at 4-10 (28 U.SC. § 1331 holding). As the magistrate wrote:

> Plaintiffs correctly note that, because they may succeed on their New Jersey RICO claims (Counts 1-2) and state common law claims (Counts 3-10) without establishing liability under federal law, the Amended Complaint . . . does not raise necessarily a substantial issue of federal law.

Report and Recommendation, ECF No. 36, at 8.

Next, the magistrate judge rejected Defendants' alternative argument that there is exclusive jurisdiction

in the federal courts pursuant to § 27 of the Exchange Act. *See* Report and Recommendation, ECF No. 36, at 10-12. The magistrate found that the references to violations of the Exchange Act in the Amended Complaint "merely [] support independent state causes of action." Report and Recommendation, ECF No. 36, at 10-11. *See also* Plaintiffs' Reply, ECF No. 30, at 2 ("The gravamen underlying Plaintiffs' Amended Complaint is not that Defendants violated Reg. SHO or other federal regulations, but that by manipulating the value of Escala stock through unlawful naked short sales, Defendants engaged in a pattern of racketeering activity in violation of New Jersey law, resulting in Plaintiffs suffering significant damages.'") (cited in Report and Recommendation, ECF No. 36, at 10).

4. The district court rejected the magistrate's recommendation and denied the motion to remand on March 20, 2013. Pet. App. 25a. The court began by stating the fundamental—but mistaken—premise of its decision:

> Notably, Plaintiffs do not dispute that the alleged unlawful conduct is predicated on a violation of Regulation SHO, 17 C.F.R. § 242.204, promulgated by the Securities and Exchange Commission ("SEC").

Pet. App. 29a.

The district court was confused. As Plaintiffs explained and the magistrate understood, Defendants' unlawful conduct consisted of violating duties owed to Plaintiffs under New Jersey law. *See, e.g.*, Pet. App. 43a (AC ¶ 2) (making clear that entire complaint is based on violations of state law without predication on any violation of Regulation SHO); Motion to Remand, ECF

No. 11-2, at 16-17 (same); Report and Recommendation, ECF No. 36, at 10-11 (recognizing same).

The district court's conclusions that there is exclusive jurisdiction under § 27 of the Exchange Act, *see* Pet. App. 30a-32a, and that there is "arising under" jurisdiction, *see* Pet. App. 32a-38a, both resulted entirely from its mistaken premise. *See* Pet. App. 32a ("As the case at bar is premised upon and its resolution depends upon the alleged violation of a regulation promulgated under the Act, this Court has jurisdiction."); Pet. App. 33a ("To prevail on their various state law claims, [] Plaintiffs must show that the alleged naked short sales were illegal.").

5. The Third Circuit reversed. Pet. App. 6a. First, the Third Circuit rejected Defendants' argument that there is "arising under" jurisdiction. Pet. App. 11a-18a. In so doing, it determined that Plaintiffs' allegations referring to violations of federal law were merely intended as *evidence* that New Jersey state law was violated. *See* Pet. App. 14a-15a (citing *Lippitt v. Raymond James Fin. Servs., Inc.*, 340 F.3d 1033, 1037 (9th Cir. 2003) (no jurisdiction even where the complaint "unnecessarily describes the alleged conduct of the defendants in terms that track almost verbatim the misdeeds proscribed by [federal law].") (alteration in original)). In this case, the Third Circuit concluded: "no causes of action are predicated *at all* on a violation of Regulation SHO." Pet. App. 14a. *See also* Pet. App. 13a ("Regulation SHO is not an element of Plaintiffs' claims. . . ." "The claims, therefore, could be decided without reference to federal law.").[3]

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[3] The Third Circuit also decided—in the alternative—that "even if Plaintiffs' claims were *partially* predicated on federal law," there

Second, the Third Circuit turned to the Petition Question regarding the meaning of § 27 of the Exchange Act. Pet. App. 18a-22a. In order to do so, the court assumed—for the sake of argument—that Plaintiffs' claims "were partially predicated on federal law." Pet. App. 15a (emphasis omitted).[4] In answering the Petition Question, the Third Circuit determined that *if* a state law claim has a sufficient "federal ingredient" to satisfy 28 U.S.C. § 1331, then § 27 of the Exchange Act makes that jurisdiction "exclusive." Pet. App. 20a, 22a. If the state law claim, however, does *not* include a sufficient federal ingredient to satisfy 28 U.S.C. § 1331, then § 27 cannot itself confer jurisdiction. Pet. App. 20a, 22a.

REASONS FOR DENYING THE PETITION

I. Because of the Antecedent Fact Question, This Case Is a Poor Vehicle for Resolution of the Petition Question.

In an effort to obtain further review, Petitioners have mischaracterized the decision below. Specifically, the Petition asserts that:

> Both courts below held that respondents' claims, while framed as state-law causes of

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would still not be jurisdiction under 28 U.S.C. § 1331. Pet. App. 15a. The court explained that alleging federal violations along with state offenses as possible predicate acts of racketeering under NJRICO does not necessarily raise a federal question. Pet. App. 15a. *See also* Pet. App. 18a ("Plaintiffs' claims could rise or fall entirely based on the construction of state law."). And Defendants' arguments that federal law contradicted Plaintiffs' claims did not authorize removal under the well-pleaded complaint rule. Pet. App. 16a-18a.

[4] Without that assumption, § 27 of the Exchange Act would not be triggered at all. *See infra* 16-18.

> action, are based on alleged violation of, and seek to enforce duties created by, the SEC's Regulation SHO, which specifies the circumstances under which securities transactions known as 'short sales' and 'naked short sales' are permissible, and when they are not.

Pet. 3.[5] That is plainly untrue. *See, e.g.*, Pet. App. 13a ("Regulation SHO is not an element of any of Plaintiffs' claims."); Pet. App. 14a ("As we read the Amended Complaint, no causes of action are predicated *at all* on a violation of Regulation SHO.") (emphasis in original).[6]

As such, this Court cannot reach the Petition Question without first reversing the Third Circuit's holding on the Antecedent Fact Question. And as evidenced by Petitioners' attempted sleight-of-hand, the Antecedent Fact Question is not fairly subsumed in the Petition Question. To the contrary, its resolution by the Third Circuit is an independent rationale for the judgment below. And because the petition ignores—or, more accurately, attempts to hide—this adequate alternative basis for affirmance, it should be denied. *See Goldlawr, Inc. v. Heiman*, 369 U.S. 463, 465 n.5 (1962).

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[5] *See also* Pet. 11 ("As a threshold matter, the Third Circuit agreed with the district court that respondents' claims, while nominally asserted under state law, all sought to establish a violation of or enforce a duty created by Regulation SHO.").

[6] *See also* Pet. App. 15a ("Nor, for the reasons above, do we think Plaintiffs' causes of action necessarily need to be predicated on a violation of Regulation SHO for Plaintiffs to have a chance at recovering under state law.").

II. In Any Event, the Petition Question Itself Does Not Warrant Further Review.

Even if this case were an appropriate vehicle to address the Petition Question, the Petition should be denied. According to the Petition, further review is warranted because the Question Presented was incorrectly answered by the Third Circuit, Pet. 21-25; is of national importance, Pet. 25-27; and is the subject of a deep and intractable circuit split, Pet. 13-19. But as explained below, none of those claims is correct.

A. The Third Circuit properly answered the Petition Question.

The Third Circuit properly held "that § 27 [of the Exchange Act] is coextensive with [28 U.S.C.] § 1331 for purposes of establishing subject-matter jurisdiction." Pet. App. 22a. Petitioners argue that the court of appeals' holding is (i) irreconcilable with the text of § 27, Pet. 21-23; (ii) undermines § 27's central purpose, Pet. 23-24; and (iii) is inconsistent with this Court's precedents, Pet. 19-20. Petitioners are mistaken on all counts:

1. First, Petitioners insist that the decision below is irreconcilable with the text of the Exchange Act. Pet. 21-23. Petitioners are wrong.

Section 27 either adds to § 1331 jurisdiction or it does not. It can only do the former if the phrase "brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder" is more far reaching than the "arising under" language in § 1331.[7]

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[7] Put another way, the Question Presented turns not, as the Petition suggests, on the meaning of "shall have exclusive jurisdiction," Pet. 21-22, but rather on the meaning of "brought to

The Petition concludes it is, and without any analysis or explanation, boldly asserts that "[t]he language of § 27 could not be clearer." Pet. 34. That is ironic because, according to the Second Circuit, the language of § 27 echoes § 1331 and "plainly refers to claims created by the Act or by rules promulgated thereunder, but not to claims created by state law." *Barbara v. N.Y. Stock Exch., Inc.*, 99 F.3d 49 (2d Cir. 1996) (citations omitted) ("*Barbara*").

As the Third Circuit explained, Pet. App. 19a-20a, this Court has already rejected Petitioners' textual argument. *Pan Am. Petroleum Corp. v. Super. Ct. of Del. for New Castel Cnty.*, 366 U.S. 656 (1961) ("*Pan American*") involved § 22 of the Natural Gas Act ("NGA"), 15 U.S.C. § 717u—a provision whose language is materially identical to § 27 of the Exchange Act.[8] There, this Court explicitly rejected the "plain meaning" argument advanced in the Petition: it concluded that the meaning of the phrase "brought to enforce any liability

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enforce any liability or duty created by this chapter or the rules and regulations thereunder."

[8] *Compare* 15 U.S.C. § 717u ("The District Courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules, regulations, and orders thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by, or to enjoin any violation of, this chapter or any rule, regulation, or order thereunder.") *with* 15 U.S.C. § 78aa(a) ("The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder.").

or duty created by" was coextensive with, and not broader than, § 1331. *Compare Pan American*, 366 U.S. at 665 n.2 ("The foregoing conclusions are not affected by want of explicit limitation to jurisdiction 'arising under' the Natural Gas Act [because s]uch limitation is clearly implied, as the authoritative Committee Reports indicate.") (quoting H. R. Rep. No. 709, 75th Cong., 1st Sess., p. 9 (1937); S. Rep. No. 1162, 75th Cong., 1st Sess., p. 7 (1937)) *with* Pet. 22-23 ("The specific jurisdictional language reflected in § 27 is different from, and broader than, the general 'arising under' language of § 1331, confirming that § 27 is *not* 'coextensive with § 1331,' as the Third Circuit held.") (emphasis in original).[9]

2. Petitioners next contend that the decision below "undermines § 27's central purpose: 'to achieve greater uniformity of construction and more effective and expert application of that law.'" Pet. 23 (citation omitted). This contention is hard to take seriously.

The Petition warns of the "danger presented where state-court judges who are not fully expert in federal securities law endeavor to interpret and enforce those laws . . . ." Pet. 24 (quotation marks omitted). For over 80 years, however, state courts have regularly and competently adjudicated complex questions of federal securities law.

It is beyond any serious dispute that the provision for exclusive federal jurisdiction in § 27 does not mean that state courts have *no role* in the adjudication and interpretation of issues involving the Exchange Act.

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[9] Although the Petition labors mightily to distinguish *Pan American* from this case, Pet. 24-25, it fails to even mention the relevant language (quoted above) from the *Pan American* opinion.

Indeed, it has been well settled for decades that § 27 "tolerates serious state intrusions into the uniform, federal adjudication of the Exchange Act." Note, *The Securities Exchange Act and the Rule of Exclusive Federal Jurisdiction*, 89 Yale L.J. 95, 110 (1979). For example:

State courts frequently resolve the facts and law pertaining to Exchange Act defenses. *See, e.g., Banque Indosuez v. Pandeff*, 603 N.Y.S.2d 300, 303 (N.Y. App. Div. 1993) (concluding that state courts' consideration of Exchange Act-based defenses "neither violates the Securities Exchange Act nor offends notions of federalism"); *Scope Indus. v. Skadden, Arps, Slate, Meagher & Flom*, 576 F. Supp. 373 (C.D. Cal. 1983) (acknowledging that state courts are competent to adjudicate the merits of Exchange Act-based defenses); *Birenbaum v. Bache & Co., Inc.*, 555 S.W.2d 513, 516 (Tex. Civ. App. 1977) (state court had power to make findings of law and fact because "the issue of [the Exchange Act] violation only appeared by way of defense," and thus it was "merely a question in the case, rather than a claim for relief").

State court findings of fact concerning Exchange Act defenses are frequently given preclusive effect in federal actions concerning related Exchange Act claims. *See, e.g., Maidman v. O'Brien*, 473 F. Supp. 25 (S.D.N.Y. 1979) (denying re-litigation of Exchange Act claim); *Osadchy v. Gans*, 436 F. Supp. 677, 684-85 (D.N.J. 1977) (where issues of scienter and reasonable reliance were resolved in earlier state court proceeding, the federal court "must conclude that [the Exchange Act] action is barred . . . by the doctrine of collateral estoppel"); *Connelly v. Balkwill*, 174 F. Supp. 49 (N.D. Ohio 1959) (applying doctrines of res judicata and collateral estoppel

to bar plaintiffs from re-litigating Exchange Act claims and issues that were previously decided in state court).

And state court approval of settlements releasing Exchange Act claims are frequently recognized in federal courts despite the grant of exclusive jurisdiction in § 27 of the Exchange Act. *See, e.g.*, *Matsushita Elec. Indus. Co., Ltd. v. Epstein*, 516 U.S. 367, 368 (1996) (state court's approval of a comprehensive settlement to release Exchange Act claims "preclude[s] ongoing or future federal-court litigation of any released claims"); *Facebook, Inc. v. Pacific Northwest Software, Inc.*, 640 F.3d 1034 (9th Cir. 2011) (mediation settlement agreement, providing mutual release of all claims arising out of transaction that gave rise to the mediation, barred Exchange Act claims); *Grimes v. Vitalink Commc'ns Corp.*, 17 F.3d 1553, 1564 (3d Cir. 1994) (state court's approval of settlement releasing parties' federal securities laws claims "was entitled to full faith and credit by the district court even though the state court did not have jurisdictional competency to entertain the present exclusive federal [Exchange Act] claims").

Petitioners invite this Court to revisit its long-standing interpretation of materially identical Congressional language based upon vague and unsupported assertions about the "central purpose" of § 27 of the Exchange Act. *Cf.* American Law Institute, *Study of the Division of Jurisdiction Between State and Federal Courts* 183 (1969) ("ALI Jurisdiction Study") (concluding, based on legislative history, that the congressional grant of Exchange Act exclusive jurisdiction was largely the result of "pure happenstance"); *Lippitt v. Raymond James Fin. Servs., Inc.*, 340 F.3d 1033, 1044 n.6 (observing that "[s]ome courts have recognized that there is little legislative

history to explain the purpose of Section 27's grant of exclusive federal jurisdiction.") (citations omitted). That invitation should be declined.[10]

3. Finally, Petitioners argue that the Third Circuit's resolution of the Petition Question cannot be reconciled with three decisions of this Court. Pet. 19-20 (briefly discussing *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010) ("*Morrison*"), *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979) ("*Touche Ross*"), and *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964)) ("*Borak*"). Again, Petitioners are mistaken.

As explained above, the Third Circuit correctly held that § 27 of the Exchange Act does not confer jurisdiction over a cause of action created by state law unless that cause of action has a federal ingredient sufficient to satisfy the test for "arising under" jurisdiction pursuant to 28 U.S.C. § 1331. *See supra* 16-18. Neither *Morrison* nor *Touche Ross* nor *Borak* hold or suggest otherwise.

In *Morrison*, the only question presented was "whether § 10(b) of the . . . Exchange Act . . . provides a cause of action to foreign plaintiffs suing foreign and American defendants for misconduct in connection with securities traded on foreign exchanges." *Morrison*, 561 U.S. at 250-51. The plaintiffs in that case "alleged

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[10] The extensive role of state courts in addressing Exchange Act issues has even prompted some notable commentators to argue that "the dubious advantages of exclusive federal jurisdiction do not sufficiently outweigh the complexities it has created . . . and the statute should be amended to conform to the concurrent-jurisdiction pattern of all of the other SEC acts." Louis Loss, *The SEC Proxy Rules and State Law*, 73 Harv. L. Rev. 1249, 1254-57 (1960). *See also* ALI Jurisdiction Study at 78-79, 183, 413.

violations of §§ 10(b) and 20(a) of the . . . Exchange Act . . . ." *Id.* at 252.[11] In *Touche Ross*, the only question presented was whether § 17(a) of the Exchange Act created an implied cause of action for damages under certain circumstances. *Touche Ross*, 442 U.S. at 562 (identifying the question presented).[12] The plaintiffs in that case asserted "federal claims . . . based on § 17(a) of the [Exchange] Act." *Id.* at 566.[13] And in *Borak*, this Court addressed whether § 27 of the Exchange Act permitted a private plaintiff to sue for violation of § 14(a) of the statute. *Borak*, 377 U.S. at 428. The plaintiffs in that case also asserted claims created by the Exchange Act itself. *See id.* at 427 ("The second count alleged a violation of § 14(a) of the . . . Exchange Act . . . .").

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[11] The defendants argued that § 10(b) of the Exchange Act did not allow plaintiffs to sue under the circumstances at issue. No one, of course, disputed that the federal court had jurisdiction to determine the scope of the § 10(b) private right of action. Indeed, in answering the question presented, this Court felt compelled to clarify that the case did not raise a question of subject matter jurisdiction *at all*. *Morrison*, 561 U.S. at 254 ("[T]o ask what conduct § 10(b) reaches is to ask what conduct § 10(b) prohibits, which is a merits question.").

[12] As in *Morrison*, *Touche Ross* did not present any question of subject matter jurisdiction. This Court's only discussion of § 27 of the Exchange Act was to contrast it with substantive provisions of the statute like §§ 10(b) or 17(a). *See Touche Ross*, 442 U.S. at 577 (explaining that § 27 "creates no cause of action of its own force and effect" and noting that "[t]he source of plaintiffs' rights must be found, if at all, in the substantive provision of the 1934 Act which they seek to enforce, not in the jurisdictional provision").

[13] Although the holding of *Touche Ross* has no relevance to the Petition Question, this Court's treatment of state law supports the decision below. *See Touche Ross*, 442 U.S. at 566 n.7 (explaining, without criticism, that an identical lawsuit, except for the omission of the Exchange Act claim at issue, was being litigated in state court).

This case, however, does *not* involve the assertion of a private right action created by the Exchange Act itself. *See supra* 9-10 (explaining that Plaintiffs expressly chose not to assert any Exchange Act claim). As such, *Morrison*, *Touche Ross*, and *Borak* do not bear whatsoever on the Petition Question.

B. Any circuit conflict over the Petition Question is limited and hardly intractable.

The decision below acknowledged some conflict between the circuits over the Petition Question. *See, e.g.*, Pet. App. 20a ("[W]e disagree with the line of Ninth Circuit cases which have held that there can be jurisdiction under § 27 . . . even when there is not under § 1331."). But, contrary to Petitioners' suggestion, Pet. 13-17, such conflict is limited and hardly intractable.

1. Including the decision below, two circuits have now squarely and correctly held that § 27 of the Exchange Act does not authorize federal jurisdiction over state law claims that fail to satisfy the "arising under" test of 28 U.S.C. § 1331. *See Barbara*, 99 F.3d at 55 ("Our determination that Barbara's state court complaint did not 'arise under' federal law within the meaning of section 1331 effectively resolves our inquiry under section 27 of the Exchange Act as well."); Pet. App. 22a ("We agree with the Second Circuit's holding in *Barbara* that § 27 is coextensive with § 1331 for purposes of establishing subject–matter jurisdiction . . . .").

Petitioners suggest that the Second Circuit has somehow retreated from its *Barbara* holding. *See* Pet. 17 n.3 (citing *NASDAQ OMX Grp., Inc. v. UBS Sec., LLC*, 770 F.3d 1010, 1030 (2d Cir. 2014) ("*NASDAQ*") and *D'Alessio v. N.Y. Stock Exch., Inc.*, 258 F.3d 93, 100-04 (2d Cir. 2001) ("*D'Alessio*"). That is untrue.

To the contrary, the Second Circuit has made clear that a state law claim with embedded federal securities questions may only be heard in federal court if the state law claim satisfies the "arising under" test of 28 U.S.C. § 1331. *See, e.g.*, *D'Alessio*, 258 F.3d at 101 ("We find the facts present in this case distinguishable from those in *Barbara*, and conclude that the instant suit implicates a federal interest sufficiently substantial to confer subject matter jurisdiction *under section 1331*.") (emphasis added);[14] *NASDAQ*, 770 F.3d at 1030 ("In sum, upon conducting the analysis prescribed by *Gunn-Grable* . . . we conclude that the district court correctly exercised federal jurisdiction here.") (citations omitted).

2. Petitioners assert that, in conflict, "[t]he Fifth and Ninth Circuits have held that § 27 itself creates federal jurisdiction, regardless whether § 1331 separately applies." Pet. 14. That is far from clear. And to the extent it is true, it hardly represents the type of intractable lower court division that warrants immediate review by this Court.

The only Fifth Circuit case to address the issue is *Hawkins v. National Association of Securities Dealers Inc.*, 149 F.3d 330 (5th Cir. 1998). To be sure: the *Hawkins* court did hold "that § 27 provided federal jurisdiction without conducting any analysis under § 1331." Pet. 13 (citing *Hawkins*, 149 F.3d at 331-32). But

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[14] *See also D'Alessio*, 258 F.3d at 104 ("In sum, because D'Alessio's claims necessarily require a court to construe both the federal law governing securities trading on a national exchange *and* the NYSE's role, as defined under federal law, in enforcing and monitoring a member's compliance with those laws, we conclude that the federal interest underlying D'Alessio's claims is sufficiently substantial *to 'arise under' federal law within the meaning of section 1331*.") (emphasis added).

it seems beyond any serious dispute that the facts of *Hawkins* would satisfy the test announced by this Court several years after *Hawkins* in *Grable & Sons Metal Products, Inc. v. Darue Engineering & Manufacturing*, 545 U.S. 308 (2005) ("*Grable*"). As such, it is not clear that the Fifth Circuit's failure to discuss 28 U.S.C. § 1331 indicates its belief that § 27 of the Exchange Act would confer jurisdiction over a state law claim (unlike the one in *Hawkins*) that failed to satisfy the "arising under" test of 28 U.S.C. § 1331. Likely for that reason, the Third Circuit expressed its *potential* disagreement with the Fifth Circuit. *See* Pet. App. 20a n.9.

The Ninth Circuit's decision in *Sparta Surgical Corp. v. National Association of Securities Dealers, Inc.*, 159 F.3d 1209 (9th Cir. 1998), is also in tension with the decision below. But the Ninth Circuit's position on the Petition Question is murky and rapidly evolving. *See, e.g.*, *Lippitt v. Raymond James Fin. Servs., Inc.*, 340 F.3d 1033, 1042 (9th Cir. 2003) (holding that "because Lippitt challenges conduct solely under state law—irrespective of whether it is legal under [federal] rules—his claims do not fit under Section 27" because "exclusive jurisdiction, under Section 27 of the Exchange Act, is for actions 'brought to enforce any liability or duty *created* by this chapter or the rules and regulations thereunder . . . .'") (emphasis in original); *California ex rel. Lockyer v. Dynegy, Inc.*, 375 F.3d 831, 841 (9th Cir. 2004) (explaining that this case is like *Sparta* because "[t]he state lawsuit turns, entirely, upon the defendant's compliance with a federal regulation" and not like *Lippitt* where reference to federal law was hardly "unavoidable").[15] That is likely

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[15] *See also Sacks v. Dietrich*, 663 F.3d 1065, 1069 (9th Cir. 2011) (concluding that "because application of federal law is necessary to

why the Third Circuit expressed disagreement only with "*the line* of Ninth Circuit cases which have held that there can be jurisdiction under § 27 . . . even when there is not under § 1331." Pet. App. 20a (emphasis added).

C. Petitioners and their amici overstate the importance of the Petition Question.

In closing, Petitioners argue that the Petition Question is one of national importance. *See* Pet. 25-27; *see also* Brief for the Securities Industry and Financial Markets Association as Amicus Curiae Supporting Petitioners, *Merrill Lynch v. Manning*, No. 14-1132, 2015 WL 1776462 (U.S. Apr. 16, 2015). According to Petitioners, that is true for two reasons. First, the decision below "will encourage forum shopping by plaintiffs who would dress up alleged violations of federal securities law in state-law garb." Pet. 26. And second, "[t]he decision below will . . . permit state courts within the Third Circuit to insert themselves into the regulation of trade settlement and clearing for securities transactions executed on national exchanges" which "will generate substantial uncertainty and confusion for market participants." Pet. 26. Each of these claims, however, is specious.

The decision below will not encourage forum shopping by plaintiffs seeking to "dress up alleged violations of federal securities law in state-law garb." The reason is simple. Any state-law-created claims that meaningfully turn on a federal ingredient (from the Exchange Act or elsewhere) are already subject to federal jurisdiction under the test set forth by this Court

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resolve each of the state law theories, this action involves a substantial federal question").

in *Grable*. If such claims (as in this case) do not satisfy the *Grable* test, then the plaintiffs who bring them in state court can hardly be described as forum shoppers attempting to adjudicate federal claims in a more favorable venue.

It is similarly clear that the decision below will not permit state courts to interpret federal securities law in a manner that "will generate substantial uncertainty and confusion for market participants." As explained in detail above (*supra* 1-3), a dual state-federal securities regulatory regime has existed for decades. The role of states in that regime includes not only independent regulation of market conduct (*supra* 1-3), but also significant interpretation of Exchange Act provisions and rules (*supra* 18-21).

State courts have regulated securities and adjudicated defenses, counterclaims, and other Exchange Act issues for years without any evidence of crisis. Indeed, the exact position taken by the Third Circuit here has been the law in the Second Circuit for nearly two decades without any chorus of objectors. Petitioners' contrary assertions blink at reality.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

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June 2015

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Supreme Court, U.S.
FILED
JUN 10 2015
OFFICE OF THE CLERK
SUPREME COURT, U.S.

No. 14-1132

IN THE

Supreme Court of the United States

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.; KNIGHT CAPITAL AMERICAS L.P., FORMERLY KNOWN AS KNIGHT EQUITY MARKETS L.P.; UBS SECURITIES LLC; E*TRADE CAPITAL MARKETS LLC; NATIONAL FINANCIAL SERVICES LLC; AND CITADEL DERIVATIVES GROUP LLC,
Petitioners,

v.

GREG MANNING; CLAES ARNRUP; POSILJONEN AB; POSILJONEN AS; SVEABORG HANDEL AS; FLYGEXPO AB; AND LONDRINA HOLDING LTD.,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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REPLY BRIEF FOR PETITIONER

The brief in opposition confirms the case for certiorari. Respondents expressly acknowledge a conflict in the circuits on the question presented: whether § 27 of the Securities Exchange Act of 1934 provides federal jurisdiction over state-law claims seeking to establish a violation of the Act or its regulations or to enforce duties created by the Act or its regulations. Respondents nevertheless urge denial of review primarily because, they say, the Third Circuit held that their claims do not do so. But the Third Circuit held unambiguously that respondents "assert in their Amended Complaint, both expressly and by implication, that Defendants repeatedly violated federal law"—specifically, Regulation SHO, an SEC regulation promulgated under the Exchange Act. Pet. App. 9a. Contrary to respondents' suggestion, the existence of those allegations is not in doubt—the only question is whether they suffice to establish federal jurisdiction under § 27.

What respondents present as a "vehicle" objection to certiorari thus turns out to be a misplaced merits argument about the question presented. In the passages respondents cite, the Third Circuit was explaining that the state-law claims in the complaint do not *necessarily* require proof of a federal securities-law violation, which matters for *federal-question* jurisdiction under 28 U.S.C. § 1331. Respondents misunderstand that conclusion to foreclose the possibility that the claims could be subject to federal jurisdiction under § 27. But that is the question presented: whether § 27 provides jurisdiction over a state-law claim seeking to establish a federal securi-

ties-law violation or enforce a federal securities-law duty, even if § 1331 does not do so. Respondents and the Third Circuit erroneously believe that § 27 is triggered only when the state-law claim necessarily requires proof of the securities-law violation, i.e., when there is already federal jurisdiction under § 1331. That view conflates jurisdiction under § 27 with jurisdiction under § 1331, despite crucial differences in language and structure, which neither respondents nor the Third Circuit can explain.

But what matters for present purposes is that the Third Circuit explicitly recognized that respondents' state-law claims allege a violation of Regulation SHO and seek to enforce duties thereunder, meaning that they come within the plain terms of § 27. The merits question is whether § 27 means what it says and provides jurisdiction over such claims. The answer is yes. Certiorari should be granted.

A. No "Antecedent Fact Question" Prevents This Court From Answering The Question Presented In This Case

This case provides an excellent vehicle to resolve the circuit conflict about whether § 27 is an independent basis for federal jurisdiction. Respondents' "vehicle" argument rests on a fundamental misunderstanding of the decision below. As respondents note, the Third Circuit observed that "'Regulation SHO is not an element of any of Plaintiffs' claims'" and that none of the claims in the amended complaint "'are predicated at all on a violation of Regulation SHO.'" Opp. 15 (emphasis removed) (quoting Pet. App. 13a, 14a). Respondents contend that those statements demonstrate that the Third Circuit found

that their claims do not assert violations of the Exchange Act or its regulations or seek to enforce duties created by the Act or its regulations (and therefore do not fall within § 27).

Respondents are wrong. The Third Circuit explicitly concluded that "[t]here is no question that Plaintiffs assert in their Amended Complaint, both expressly and by implication, that Defendants repeatedly violated federal law," i.e., Regulation SHO, the only federal law identified in the complaint. Pet. App. 9a. The court recognized that respondents' complaint "repeatedly mentions the requirements of Regulation SHO, its background, and enforcement actions taken against some [petitioners] regarding Regulation SHO," "cites data maintained to assist broker-dealers in complying with Regulation SHO's close out requirement, and at times couches its allegations in language that appears borrowed from Regulation SHO." *Id.* at 8a-9a.

In the statements cited by respondents, the court was analyzing jurisdiction under *§ 1331* (*see* Pet. App. 13a-15a), which *does* turn on whether the federal question is "*necessarily* raised" in the state-law claim. *Grable & Sons Metal Prods., Inc. v. Darue Eng'g & Mfr'g*, 545 U.S. 308, 314 (2005) (emphasis added). The Third Circuit held that respondents' state-law claims, while invoking Regulation SHO, do not necessarily raise a federal question, because a state court could possibly find their claims meritorious without relying on Regulation SHO. *See* Pet. App. 13a-15a. That is why the Third Circuit stated that respondents' claims are not "predicated" on Regulation SHO. *See id.* at 14a.

The question presented here, however, is whether § 27 is different than § 1331, so the court's analysis under § 1331 does not resolve the § 27 inquiry. Thus, while it might not have been *necessary* for respondents to assert a violation of Regulation SHO and the duties it imposes when bringing their state-law claims, they *chose* to do so. And § 27 reflects a congressional determination that federal courts, rather than state courts, must adjudicate such claims. Respondents' "vehicle" argument simply misunderstands the question before the Court, assuming that § 27 is no different than § 1331 when the Court has been asked to decide whether that is so.

B. There Is A Direct Circuit Conflict

The Third Circuit below expressly "disagree[d]" with the decisions of the Fifth and Ninth Circuits holding that "there can be jurisdiction under § 27 (and other exclusive jurisdiction provisions) even when there is not under § 1331," Pet. App. 20a; *see id.* at 20a n.9, and instead "agree[d]" with the Second Circuit's holding "that § 27 is coextensive with § 1331 for purposes of establishing subject-matter jurisdiction," *id.* at 22a.[1] The Second Circuit has also "recently acknowledged this split." *Id.* at 19a; *see NASDAQ OMX Grp., Inc. v. UBS Secs., LLC*, 770 F.3d 1010, 1030 (2d Cir. 2014). In short, the Second and Third Circuits hold that § 27 does not provide

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[1] Respondents dispute (Opp. 23-24) petitioners' suggestion that the Second Circuit might not "follow the approach adopted in *Barbara* if it considered the issue anew today." Pet. 17 n.3. That debate is irrelevant, as all agree that *Barbara* remains controlling in the Second Circuit. *See* Pet. 17 n.3; Opp. 23.

federal jurisdiction where there is not already jurisdiction under § 1331. The Fifth and Ninth Circuits disagree, holding that § 27 *itself* creates federal jurisdiction, regardless whether § 1331 applies.

Respondents do not deny the circuit conflict, but seek to minimize it, proposing that it is somehow "far from clear" that the Fifth and Ninth Circuits have held that § 27 creates federal jurisdiction independent of § 1331. Opp. 24. In the next breath, however, respondents concede that in *Hawkins v. National Association of Securities Dealers, Inc.*, 149 F.3d 330 (5th Cir. 1998), the Fifth Circuit "did hold 'that § 27 provided federal jurisdiction without conducting any analysis under § 1331.'" Opp. 24 (quoting Pet. 13).

Respondents suggest that, because in their view the claims in *Hawkins* would satisfy *Grable*'s test for jurisdiction under § 1331—a determination the Fifth Circuit notably did not make—it is "not clear that the Fifth Circuit's failure to discuss 28 U.S.C. § 1331 indicates its belief that § 27 . . . would confer jurisdiction over a state law claim (unlike the one in *Hawkins*) that failed to satisfy the 'arising under' test of 28 U.S.C. § 1331." Opp. 25. But respondents' speculation is not supported by *Hawkins*. Under *Hawkins*, if a state-law claim "seek[s] to enforce liabilities or duties created by federal securities laws"—i.e., if it is within the plain terms of § 27—then there is federal jurisdiction, without any consideration of § 1331. 149 F.3d at 332 ("[A]ll of Hawkins's claims . . . , though carefully articulated in terms of state law, are actions at law seeking to enforce liabilities or duties created by federal securities laws which are

governed exclusively by federal courts pursuant to 15 U.S.C. § 78aa."). Nothing in *Hawkins* limits § 27's jurisdictional reach to claims "arising under" federal law within the meaning of § 1331.

Like the Fifth Circuit, the Ninth Circuit has held that § 27 provides jurisdiction over state-law claims alleging a federal securities-law violation or seeking to enforce a federal securities-law duty. *See, e.g.*, *Sparta Surgical Corp. v. Nat'l Ass'n of Secs. Dealers, Inc.*, 159 F.3d 1209, 1211 (9th Cir. 1998) ("Because Sparta's complaint sought relief based upon violation of exchange rules, subject matter jurisdiction was specifically vested in the federal district court under the Exchange Act."). Respondents nonetheless suggest that the "Ninth Circuit's position" on the question presented "is murky and rapidly evolving," citing a trio of post-*Sparta* decisions. Opp. 25 & n.15 (citing *Sacks v. Dietrich*, 663 F.3d 1065 (9th Cir. 2011); *Cal. ex rel. Lockyer v. Dynegy, Inc.*, 375 F.3d 831 (9th Cir. 2004); *Lippitt v. Raymond James Fin. Servs.*, 340 F.3d 1033 (9th Cir. 2003)). But those cases all apply the rule announced in *Sparta*. In *Sacks*, the court held that § 27 "conferred exclusive jurisdiction on the district court because the central question of th[e] case [wa]s whether FINRA rules were violated." 663 F.3d at 1069. In *Lockyer*, the court applied *Sparta* to the parallel exclusive-jurisdiction provision found in § 317 of the Federal Power Act (the "FPA") and held that § 317, like § 27, confers federal jurisdiction on claims within its terms. *See* 375 F.3d at 839-43; *see also* Pet. 18. And while in *Lippitt* the court held that there was no jurisdiction over the plaintiff's claims under § 27, the

court explained that "if [the plaintiff] were asserting a violation of an SRO rule, then . . . this would be a matter of exclusive federal jurisdiction, and therefore removal would be proper." 340 F.3d at 1042; *see* Pet. 16. Simply put, the Ninth Circuit has not deviated from *Sparta*. There is no other "line of Ninth Circuit" cases (Opp. 26) suggesting a different rule.

The circuit conflict here is reflected in (and confirmed by) district court decisions divided on the same § 27 jurisdictional issue. *See* Pet. 16, 17. And it extends to circuit decisions interpreting the parallel exclusive-jurisdiction provisions in the Natural Gas Act (the "NGA") and the FPA. *Id.* at 17-19. Review by this Court to resolve this disarray is urgently needed.

C. The Third Circuit's Decision Is Wrong

Respondents' merits arguments only demonstrate their weakness. They do not justify permitting an acknowledged circuit conflict on an important and recurring question of federal securities law and federal jurisdiction to persist.

1. Respondents have no answer to the obvious point that the words "shall have exclusive jurisdiction" cannot create *less* jurisdiction than the words "shall have jurisdiction." Pet. 21-22. Respondents instead parrot the Second Circuit's theory in *Barbara v. New York Stock Exchange, Inc.*, 99 F.3d 49 (2d Cir. 1996), that to the extent § 27 provides jurisdiction, it does so only for federal claims for which there would already be jurisdiction under § 1331. *See* Opp.

16-17 & n.7; *see also Barbara*, 99 F.3d at 55.[2] Neither respondents nor the Second Circuit, however, even attempt to reconcile this conclusion with the obvious differences in the language of the two statutes. *See* Pet. 21-23.

Respondents contend that in *Pan American Petroleum Corp. v. Superior Court of Delaware for New Castle County*, 366 U.S. 656 (1961), this Court held that the differences between the language of § 1331 and that of § 27 are meaningless. *See* Opp. 17-18. As petitioners have explained, *Pan American* is a straight-forward application of the "well-pleaded complaint" rule that issues raised only by way of defense do not create jurisdiction, which has nothing to do with jurisdiction here, where federal law is invoked on the face of the complaint. *See* Pet. 24-25. Respondents ignore that point entirely and instead focus on a single sentence in a footnote, which noted in passing that even though the NGA's exclusive-jurisdiction provision, § 22, does not contain the words "arising under," § 22 still did not supply federal jurisdiction over cases raising NGA issues only by way of a defense, because a limitation to claims "arising under" the NGA was implicit. 366 U.S. at 665 n.2; *see* Opp. 17-18. That observation goes back

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[2] Under the Second Circuit's view, § 27 is not coextensive with § 1331, but actually *narrower*, because § 1331 reaches "state-law claim[s] [that] necessarily raise a stated federal issue, actually disputed and substantial, which a federal forum may entertain without disturbing any congressionally approved balance of federal and state judicial responsibilities," *Grable*, 545 U.S. at 314, while the Second Circuit believes § 27 does not apply to "claims created by state law" at all, *Barbara*, 99 F.3d at 55.

to the well-pleaded complaint rule, which again is irrelevant here.

Even if this Court otherwise believed at the time it decided *Pan American* that NGA § 22 was coextensive with § 1331, that conclusion no longer holds. When *Pan American* was decided, "arising under" jurisdiction was defined broadly to include *any* claim requiring "construction or application" of federal law, so long as the federal claim was "not merely colorable." *Smith v. Kansas City Title & Trust Co.*, 255 U.S. 180, 199 (1921). That standard encompasses every claim falling within § 22 of the NGA (and § 27 of the Exchange Act). Since *Pan American*, however, § 1331's "arising under" jurisdiction has been scaled back significantly. *See Grable*, 545 U.S. at 314 (requiring "substantial," disputed federal issue); *id.* at 312-13 (explaining that *Smith*'s "generous statement of the scope" of federal-question jurisdiction "has been subject to some trimming"). But § 27 has not been comparably restricted, and there is no basis in its text or history for doing so. At the very least, evolution of the law since *Pan American* was decided leaves its application here subject to serious doubt, further confirming the need for this Court's review.

The footnote dictum in *Pan American*, moreover, was based not on § 22's text, but on its legislative history, which specified that the provision governed "cases *arising under* the act." 366 U.S. at 665 n.2 (emphasis added) (quoting S. Rep. No. 1162, at 7 (1937)); *see* H.R. Rep. No. 709, at 9 (1937) (same). There is no analogous legislative history for § 27. *See Matsushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367, 383 (1996).

2. Unable to establish a serious textual basis for their position, respondents try to insist that the purpose of § 27 undermines federal jurisdiction. *See* Opp. 20. But this Court has already held that "Congress intended § 27 to serve at least the general purposes underlying most grants of exclusive jurisdiction: to achieve greater uniformity of construction and more effective and expert application of" the Exchange Act and the rules and regulations promulgated thereunder. *Matsushita*, 516 U.S. at 383 (internal quotation omitted).[3]

Accordingly, it is irrelevant that state courts in other contexts sometimes "adjudicate[] complex questions of federal securities law." Opp. 18. What matters is that, as this Court has recognized, Congress did not believe that state courts could provide uniform, effective, and expert application of the Act when adjudicating claims asserting violations of or duties under the Act. The other contexts cited by respondents only underscore the point. For example, state courts are permitted to resolve Exchange Act *defenses* (Opp. 19) only because of the well-pleaded complaint rule, *see Caterpillar Inc. v. Williams*, 482 U.S. 386, 392 (1987), which has no bearing here, *see supra* at 8. And state courts of course sometimes approve settlements releasing Exchange Act claims (Opp. 20), but they need not interpret federal securities law to do so. *See Matsushita*, 516 U.S. at 383. Respondents can cite no case allowing a state court

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[3] This Court's conclusion about § 27's purpose is rather more compelling than the commentary cited by respondents. *See* Opp. 20-21.

to adjudicate claims asserting violations of SEC trading rules.

3. Respondents distinguish this Court's decisions in *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010), *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979), and *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964), all of which described § 27 in jurisdiction-creating terms irreconcilable with the Third Circuit's view that § 27 does not "grant" jurisdiction, but merely eliminates concurrent state-court jurisdiction. *See* Pet. 19-20. Respondents do not and cannot deny the statements in these opinions, but argue only that the decisions themselves did not conclusively resolve the question presented here. *See* Opp. 21-23. But this Court's statements regarding § 27 highlight the need for the Court to resolve the circuit conflict.

D. The Case Presents An Issue Of National Importance

Finally, respondents assert that review is unwarranted because the question presented is unimportant. *See* Opp. 26-27. That contention is belied by the involvement of the Securities Industry and Financial Markets Association as *amicus* in this case, both in this Court and below.

Respondents insist there is no danger of forum-shopping, because any state-law claims that "meaningfully turn on a federal ingredient" are subject to § 1331 jurisdiction. Opp. 26-27. Of course, the standard for establishing jurisdiction under § 1331 is more demanding than whether a claim "meaningfully turn[s] on a federal ingredient." *See Grable*, 545

U.S. at 314 ("[T]he question is, does a state-law claim necessarily raise a stated federal issue, actually disputed and substantial, which a federal forum may entertain without disturbing any congressionally approved balance of federal and state judicial responsibilities."). And this case itself proves respondents wrong. Even if § 1331 provides federal jurisdiction over some state-law claims also covered by § 27, the latter provision provides federal jurisdiction over some claims where § 1331 does not. The Third Circuit's decision simply invites plaintiffs to avoid federal jurisdiction through creative pleading.

SIFMA's involvement shows that this is a problem worth addressing. And respondents do not dispute that because there is ordinarily no appellate review of a remand order based on a lack of jurisdiction, this case provides a rare opportunity for the Court to intervene. *See* Pet. 27.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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June 10, 2015

Supreme Court, U.S.
FILED
SEP - 3 2015
OFFICE OF THE CLERK

No. 14-1132

IN THE

Supreme Court of the United States

MERRILL LYNCH, PIERCE, FENNER & SMITH, INCORPORATED; KNIGHT CAPITAL AMERICAS L.P., FORMERLY KNOWN AS KNIGHT EQUITY MARKETS L.P.; UBS SECURITIES LLC; E*TRADE CAPITAL MARKETS LLC; NATIONAL FINANCIAL SERVICES LLC; AND CITADEL DERIVATIVES GROUP LLC,

Petitioners,

v.

GREG MANNING; CLAES ARNRUP; POSILJONEN AB; POSILJONEN AS; SVEABORG HANDEL AS; FLYGEXPO AB; AND LONDRINA HOLDING LTD.,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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QUESTION PRESENTED

Section 27 of the Securities Exchange Act of 1934 provides that federal courts "shall have exclusive jurisdiction" over "violations of [the Act] or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by [the Act] or the rules and regulations thereunder." 15 U.S.C. § 78aa(a).

The question presented is:

Whether § 27 of the Securities Exchange Act of 1934 provides federal jurisdiction over state-law claims seeking to establish liability based on violations of the Act or its regulations or seeking to enforce duties created by the Act or its regulations.

PARTIES TO THE PROCEEDING

Petitioners are Merrill Lynch, Pierce, Fenner & Smith, Incorporated; Knight Capital Americas L.P., formerly known as Knight Equity Markets L.P.; UBS Securities LLC; E*TRADE Capital Markets LLC; National Financial Services LLC; and Citadel Derivatives Group LLC, now known as Citadel Securities LLC, defendants below.

Respondents are Greg Manning; Claes Arnrup; Posiljonen AB; Posiljonen AS; Sveaborg Handel AS; Flygexpo AB; and Londrina Holding Ltd., plaintiffs below.

RULE 29.6 STATEMENT

Petitioner Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") is an indirect wholly owned subsidiary of Bank of America Corporation, a publicly held corporation. No publicly held company holds 10% or more of Bank of America Corporation's stock.

Petitioner Knight Capital Americas L.P. merged into an entity which became Knight Capital Americas LLC on July 1, 2012. Knight Capital Americas LLC became KCG Americas LLC ("Knight") after the market close on December 31, 2013. Knight is a subsidiary of Knight Capital Group, Inc., which is wholly owned by KCG Holdings, Inc., a publicly traded company. Jefferies Group LLC holds 10% or more of KCG Holdings, Inc.'s stock. Jefferies Group LLC is a wholly owned subsidiary of Leucadia National Company, which is a publicly traded holding company.

Petitioner UBS Securities LLC is wholly owned by UBS AG and UBS Americas Inc. UBS Americas Inc. is wholly owned by UBS AG, and over 90% of the stock of UBS AG is held by UBS Group AG, a publicly traded company. Aside from UBS Group AG, UBS AG, and UBS Americas Inc., no other publicly held company holds 10% or more of the stock of UBS Securities LLC. No publicly held company holds 10% or more of the stock of UBS Group AG.

Petitioner ETCM Holdings, Inc. ("ETCM") was the sole member of E*TRADE Capital Markets LLC, formerly known as G1 Execution Services, LLC ("G1"). ETCM owned 100% of G1 until G1 was sold. ETCM retained G1's potential liability for this matter. ETCM is a direct subsidiary of E*TRADE Financial Corporation, a publicly held corporation. No publicly held corporation owns 10% or more of E*TRADE Financial Corporation's stock.

Petitioner National Financial Services LLC ("NFS") is an indirect, wholly owned subsidiary of FMR LLC ("FMR"), which is a privately held corporation. No publicly held corporation owns 10% or more of NFS's or FMR's stock.

Petitioner Citadel Derivatives Group LLC, n/k/a Citadel Securities LLC ("Citadel Securities") has no parent corporation, and no publicly held corporation owns 10% or more of Citadel Securities' stock.

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OPINIONS BELOW

The decision of the court of appeals is reported at 772 F.3d 158 and is reprinted in the Appendix to the Petition ("Pet. App.") at 1a-23a.[1] The district court's opinion is unpublished but is reported at 2013 WL 1164838 and is reprinted at Pet. App. 24a-38a.

JURISDICTION

The court of appeals issued its decision on November 10, 2014. Pet. App. 2a. A timely petition for rehearing and rehearing en banc was denied on January 15, 2015. Pet. App. 40a. The petition for a writ of certiorari was filed on March 17, 2015, and granted on June 30, 2015. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

Section 27 of the Securities Exchange Act of 1934 (the "Exchange Act" or "Act") provides in relevant part:

> The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter [i.e., the Act] or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder.

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[1] An unopposed motion for leave to dispense with the filing of a joint appendix is currently pending before the Court.

15 U.S.C. § 78aa(a).

INTRODUCTION

In § 27 of the Exchange Act, Congress conferred on federal courts "exclusive jurisdiction of violations of [the Act] or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by [the Act] or the rules and regulations thereunder." The jurisdictional test established by that language is clear and simple: if the complaint on its face alleges a violation of the Act or its regulations, or seeks to enforce a liability or duty created by the Act or its regulations, then federal courts have exclusive jurisdiction. The complaint here does exactly that, in unambiguous terms—as both the court of appeals and district court concluded and as respondents did not dispute below—thereby giving the federal courts exclusive jurisdiction.

Jurisdiction is not always so simple, but that is no reason to complicate things when it is. There is no reason, for example, to read into § 27 the complex, multifactor jurisdictional test this Court has read into the general "arising under" jurisdictional statute for reasons that have nothing to do with the language and objectives of § 27. And there is certainly no reason to read *out* of § 27 the obvious jurisdictional force of the words "shall have exclusive jurisdiction," as the Third Circuit did in this case.

Absent some compelling reason to conclude otherwise, statutes must be read to mean what they say. Even jurisdictional statutes—*especially* jurisdictional statutes. And § 27 says that there is exclu-

sive federal jurisdiction over respondents' complaint here, because it seeks both a judicial determination that an Exchange Act regulation—Regulation SHO, 17 C.F.R. § 242.200 *et seq.*—was violated and judicial action to enforce the duties imposed by that regulation. The decision below finding no federal jurisdiction should be reversed.

STATEMENT OF THE CASE

A. Statutory And Regulatory Background

1. a. "In the wake of the 1929 stock market crash and in response to reports of widespread abuses in the securities industry, the 73d Congress enacted two landmark pieces of securities legislation": the Securities Act of 1933 (the "Securities Act") and the Exchange Act. *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 170 (1994). The Exchange Act "is general in scope but chiefly concerned with the regulation of post-distribution trading on the Nation's stock exchanges and securities trading markets." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 752 (1975). The Securities Act, in contrast, "is a far narrower statute chiefly concerned with disclosure and fraud in connection with offerings of securities—primarily . . . initial distributions of newly issued stock from corporate issuers." *Id.*

The Exchange Act's expansive scope reflects the broad national interests the Act serves, as the Act's statement of purpose explicitly sets forth.[2] Entitled "Necessity for regulation," § 2 of the Exchange Act

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[2] The Securities Act contains no similar statement.

explains that "transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are effected with a national public interest which makes it necessary to provide for regulation and control of such transactions" so as to "remove impediments to and perfect the mechanisms of a national market system for securities and a national system for the clearance and settlement of securities transactions." 15 U.S.C. § 78b.

The Act further emphasizes that transactions conducted on exchanges must be subject to national regulation because they (i) "are carried on in large volume by the public generally and in large part originate outside the States in which the exchanges and over-the-counter markets are located and/or are effected," (ii) "constitute an important part of the current of interstate commerce," (iii) "involve in large part the securities of issuers engaged in interstate commerce," and (iv) "affect the national credit." *Id.* § 78b(1). And because "the prices of securities on such exchanges and markets are susceptible to manipulation and control," the "dissemination of such prices [throughout the United States and foreign countries] gives rise to excessive speculation, resulting in sudden and unreasonable fluctuations in the prices of securities." *Id.* § 78b(3); *see id.* § 78b(2). Such fluctuation can cause, among other things, "alternately unreasonable expansion and unreasonable contraction of the volume of credit available for trade, transportation, and industry in interstate commerce." *Id.* § 78b(3). The federal government has a strong interest in regulating trading on national exchanges, the Act observes, because "manipu-

lation" and "excessive speculation" can "precipitate[]" and "prolong[]" national economic crises that can subject the federal government to "such great expense as to burden the national credit." *Id.* § 78b(4).

b. The uniquely federal interests the Exchange Act protects are reflected in § 27 of the Act, which confers on federal district courts "exclusive jurisdiction of violations of [the Act] or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by [the Act] or the rules and regulations thereunder." 15 U.S.C. § 78aa(a).

This Court has recognized that § 27 was "intended . . . to serve at least the general purposes underlying most grants of exclusive jurisdiction: to achieve greater uniformity of construction and more effective and expert application of" the Exchange Act's regulatory scheme. *Matsushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367, 383 (1996) (quotation omitted). Section 27 secures uniformity and expertise in the application of that scheme by eliminating any "danger that state-court judges who are not fully expert in federal securities law will say definitively what the Exchange Act means and enforce legal liabilities and duties thereunder." *Id.*

2. The Exchange Act also established the Securities Exchange Commission ("SEC"), 15 U.S.C. § 78d(a), which has authority to promulgate rules and regulations under the Act. Under that authority, the SEC adopted Regulation SHO, 17 C.F.R. § 242.200 *et seq.*, to regulate "short sales" of equity securities. *See* Short Sales, SEC Release No. 34-50103, 69 Fed. Reg. 48,008 (Aug. 6, 2004).

A "short sale" is "a sale of a security that the seller does not own" or a sale that "is consummated by the delivery of a security borrowed by or on behalf of the seller." "Naked" Short Selling Antifraud Rule, SEC Release No. 34-58774, 73 Fed. Reg. 61,666, 61,667 (Oct. 17, 2008). Investors and traders engage in short selling "for many purposes, including to profit from an expected downward price movement, to provide liquidity in response to unanticipated buyer demand, or to hedge the risk of a long position in the same security or a related security." SEC, Division of Market Regulation: Key Points About Regulation SHO (Apr. 11, 2005).[3]

A short sale normally proceeds as follows: the short seller (1) identifies a security she believes will drop in price or needs to sell for hedging purposes, (2) determines whether the security is available to borrow (i.e., obtains a "locate"), (3) sells the security on the open market, (4) arranges for the security to be borrowed and delivered to the buyer, and (5) purchases a replacement security to be returned at a later date—thereby closing the short seller's position. *See Elec. Trading Grp., LLC v. Banc of Am. Sec. LLC*, 588 F.3d 128, 132 (2d Cir. 2009). The short seller's profit, if any, is the difference between the market price at which she sold the security and the market price at which she purchased the replacement security (less transaction costs and any borrowing fees). *Id.*

Through Regulation SHO, the SEC imposed various conditions on the practice of short selling. The

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[3] *Available at* http://www.sec.gov/investor/pubs/regsho.htm.

conditions relevant here are known as the "locate" and "close out" requirements. *See id.* at 135-36.

Under the locate requirement, when a broker-dealer has not already borrowed the security before executing a short sale order, the broker-dealer must have "reasonable grounds to believe" that the security can be borrowed and delivered at settlement, i.e., three days after the trade. 17 C.F.R. § 242.203(b)(1); *see* SEC, Division of Market Regulation: Key Points About Regulation SHO, *supra* ("Regulation SHO requires a broker-dealer to have reasonable grounds to believe that the security can be borrowed so that it can be delivered on the date delivery is due before effecting a short sale order in any equity security."). If the broker-dealer is unable to deliver shares at settlement, a "fail to deliver" or "fail" occurs, and the sale is described as a "naked short sale." 73 Fed. Reg. at 61,667. If the fail to deliver remains open for 13 days, the "close out" requirement obliges the broker-dealer to close it out by purchasing "securities of like kind and quantity." 17 C.F.R. § 242.203(b)(3).[4]

The SEC recognizes that naked short selling "in certain circumstances . . . contributes to market liquidity." SEC, Division of Market Regulation: Key Points About Regulation SHO, *supra*. Accordingly, SEC regulations provide that the locate requirement does not apply to short sales executed by "market makers"—entities, like many of the petitioners, responsible for maintaining market liquidity—in con-

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[4] In 2008, after the alleged conduct at issue here, Regulation SHO was amended to require fails to deliver to be closed out within one day. *See* 17 C.F.R. § 242.204.

nection with their "bona fide market-making activities," a term the Commission has not defined. 17 C.F.R. § 242.203(b)(2)(iii).

B. Respondents' Complaint

Respondent Greg Manning, the lead plaintiff below, is the founder and former CEO of Escala Group, Inc. ("Escala"), a company traded on the NASDAQ until it was delisted in 2007. The other respondents are former Escala shareholders from various countries around the world. *See* Pet. App. 45a-46a.

Respondents filed suit against petitioners in the Superior Court of New Jersey. Pet. App. 6a, 41a. In their amended complaint, respondents alleged that petitioners—financial institutions that clear and settle securities transactions at the nation's central clearinghouse—"engaged in the unlawful practice of naked short sales of Escala stock by creating, loaning and selling unauthorized, fictitious and counterfeit shares" and by selling or loaning stock "that they did not own, [and] never intended to borrow or locate for delivery to buyers and close-out by settling their trades." Pet. App. 43a, 51a-52a.

Specifically, the complaint asserts that petitioners engaged in "intentional and persistent violation of *rules and regulations* governing unlawful naked short sales of securities." Pet. App. 44a (emphasis added); *see* Pet. App. 81a (alleging that petitioners violated "*regulatory prohibitions* barring the practice of naked short selling of stock" (emphasis added)).

The only "rule," "regulation," or "regulatory prohibition" governing naked short selling is Regulation SHO, which the complaint invokes in both name and

substance. After noting the difference between what respondents describe as "lawful" short sales and "unlawful," "naked" short sales, Pet. App. 49a-50a, the complaint states that, "in response to pervasive manipulative conduct in the unlawful naked short sales of securities, the [SEC] adopted Regulation SHO." Pet. App. 51a. "The general purpose of Reg SHO," respondents explain, "is to establish uniform 'Locate' and 'Close-Out' requirements and prevent unlawful naked short selling, in which market participants like [petitioners] . . . never intended to borrow or locate for delivery to buyers and close-out by settling their trades." Pet. App. 51a-52a. The complaint then surveys in detail the SEC's stated reasons for promulgating Regulation SHO. Pet. App. 52a-54a.

The complaint's factual allegations assert that petitioners violated the Regulation's locate and close-out requirements when engaging in short sales of Escala stock. Respondents invoke Regulation SHO's locate requirement nearly verbatim in alleging that petitioners perpetrated a scheme of "market manipulation," Pet. App. 43a, by "entering millions of proprietary and customer short sale transactions" without "reasonable grounds to believe that the securities could be borrowed and be available for delivery." Pet. App. 44a; *cf.* 17 C.F.R. § 242.203(b)(1)(ii) (broker or dealer must have "[r]easonable grounds to believe that the security can be borrowed so that it can be delivered on the date delivery is due"). Further, the complaint summarizes part of "the conduct described herein" as "selling Escala stock short at times when [petitioners] neither possessed nor intended to obtain Escala stock to deliver by the Settlement Date."

Pet. App. 85a; *see also* Pet. App. 88a (same). The complaint also quotes various statements by the Financial Industry Regulatory Authority ("FINRA") invoking Regulation SHO by name and alleging that the conduct described in the complaint violated the Regulation's locate requirement.[5]

Respondents allege violations of Regulation SHO's close-out requirement in asserting that petitioners "permitted [fail-to-deliver] transactions to remain unfulfilled." Pet. App. 59a; *see* 17 C.F.R. § 242.203(b)(3) (requiring broker-dealers to "close out the fail to deliver position by purchasing securities" within set number of days).

According to respondents' theory, petitioners' alleged naked short sales in violation of Regulation SHO "increased the pool of tradable shares" of Escala stock and thereby caused respondents' shares to decline in value. Pet. App. 44a. The alleged violations of Regulation SHO establish the basis for alleged liability to respondents under various state-

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[5] The complaint alleges that petitioners concealed violations of the locate requirement by "mis-mark[ing] order tickets to make transactions appear as 'long' sales when in fact, they were short sales," Pet. App. 74a, and then quotes a FINRA opinion describing an alleged concealment as "resulting in . . . significant violations of Reg SHO's locate requirement." Pet. App. 79a. The complaint also alleges that some of the petitioners previously engaged in "the same or similar" schemes alleged in the complaint, citing as examples alleged violations of Regulation SHO, including a FINRA allegation that one petitioner violated the locate requirement, and a FINRA consent order concluding that another petitioner's conduct had resulted in "serious Reg SHO failures across the Firm's equities trading business." Pet. App. 78a; *see* Pet. App. 77a-81a.

law causes of action: statutory claims under the New Jersey RICO Act and common-law claims for unjust enrichment, interference with economic advantage and contractual relations, breach of contract, breach of the covenant of good faith and fair dealing, and negligence. *See* Pet. App. 82a-101a.

C. Removal To District Court

Petitioners removed the suit to the U.S. District Court for the District of New Jersey, asserting federal jurisdiction under § 27 of the Exchange Act and 28 U.S.C. §§ 1331 and 1337. Pet. App. 9a, 26a. Respondents sought remand. Pet. App. 9a, 25a.

The district court denied respondents' motion to remand. Pet. App. 25a. The court began by analyzing the allegations in respondents' complaint. "Notably," the court observed, respondents "do not dispute that the alleged unlawful conduct is predicated on a violation of Regulation SHO." Pet. App. 29a. The court also noted that respondents' complaint cited the fact that certain petitioners have been fined by the SEC and FINRA "for their intentional and persistent violation" of the rules and regulations governing their "unlawful" short selling activities. Pet. App. 29a; *see* Pet. App. 44a.

The district court therefore concluded that "the case at bar is premised upon and its resolution depends on the alleged violation of a regulation promulgated under the Act." Pet. App. 32a. And because "'Section 27 of the Exchange Act confers exclusive jurisdiction upon the federal courts for suits brought to enforce the Act or rules and regulations promul-

gated thereunder,'" § 27 provided federal jurisdiction. *Id.* (quoting *Matsushita*, 516 U.S. at 370).

The district court also held that 28 U.S.C. §§ 1331 and 1337 separately provided federal jurisdiction, applying the test set forth in *Grable & Sons Metal Products, Inc. v. Darue Engineering & Manufacturing*, 545 U.S. 308 (2005). Pet. App. 33a. The court reiterated that respondents' claims "are predicated on [petitioners'] alleged naked short sales of Escala stock in violation of SEC Regulation SHO," explaining that respondents would need to "show that the alleged naked short sales were illegal" to prevail on their claims. *Id.* The court further noted that respondents "d[id] not point to a New Jersey law or regulation which similarly prohibits the type of alleged conduct at issue here." Pet. App. 33a-34a.

The district court subsequently certified an interlocutory appeal to the Third Circuit under 28 U.S.C. § 1292(b) to answer "the question of whether remand is appropriate in this case." *Manning v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 2013 WL 2285955, at *2 (D.N.J. May 23, 2013).

D. Proceedings Before The Third Circuit

The Third Circuit granted respondents' petition to appeal, Pet. App. 5a, 10a, and reversed the district court's decision declining to remand the case.

As a threshold matter, the Third Circuit agreed with the district court that respondents' claims, while nominally asserted under state law, all sought to establish a violation of or enforce a duty created by Regulation SHO. Pet. App. 8a-9a. The court emphasized that the complaint "repeatedly mentions

the requirements of Regulation SHO, its background, and enforcement actions taken against some [petitioners] regarding Regulation SHO." Pet. App. 8a. The court further observed that the complaint "cites data maintained to assist broker-dealers in complying with Regulation SHO's close out requirement, and at times couches its allegations in language that appears borrowed from Regulation SHO." Pet. App. 8a-9a. "There is no question," the court concluded, "that [respondents] assert in their Amended Complaint, both expressly and by implication, that [petitioners] repeatedly violated federal law," i.e., Regulation SHO. Pet. App. 9a.

The Third Circuit nevertheless held that § 27 did not establish jurisdiction over respondents' claims, holding that § 27 does not itself confer federal jurisdiction, but instead operates only to "divest state courts of jurisdiction" over claims that *otherwise* raise federal questions. Pet. App. 22a.

The Third Circuit's construction of § 27 rested on that court's interpretation of *Pan American Petroleum Corp. v. Superior Court of Delaware In & For New Castle County*, 366 U.S. 656 (1961). Pet. App. 19a-20a. In *Pan American*, this Court considered not § 27 of the Exchange Act, but § 22 of the Natural Gas Act, which contains similar exclusive-jurisdiction language. *See* Pet. App. 20a. The Third Circuit recited *Pan American*'s observation that, in § 22, "'[e]xclusive jurisdiction' is given the federal courts but it is 'exclusive' only for suits that may be brought in the federal courts. Exclusiveness is a consequence of having jurisdiction, not the generator of jurisdiction because of which state courts are ex-

cluded." *Id.* (quoting *Pan American*, 366 U.S. at 664). The court read that statement to mean that § 22 of the Natural Gas Act could never provide federal jurisdiction where it did not otherwise exist under § 1331 and saw "no reason" to distinguish between § 22 of the Natural Gas Act and § 27 of the Exchange Act. *Id.*

Based on that reasoning, the court of appeals rejected the position (previously adopted by the Fifth and Ninth Circuits) that "there can be jurisdiction under § 27 (and other exclusive jurisdiction provisions) even when there is not under § 1331." Pet. App. 20a. Section 27, the court concluded, "does not provide an independent basis to exercise jurisdiction" over respondents' claims. Pet. App. 22a.[6]

SUMMARY OF ARGUMENT

Respondents' complaint on its face alleges that petitioners violated Regulation SHO and seeks to enforce duties created by that regulation. The district court thus had jurisdiction under § 27 of the Exchange Act. The Third Circuit's and respondents' contrary positions are meritless.

I. Section 27 of the Exchange Act confers exclusive federal jurisdiction over respondents' complaint.

A. Section 27's plain language resolves this case. That provision grants exclusive federal jurisdiction "of violations of" the Exchange Act or regula-

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[6] The Third Circuit separately rejected the district court's holding that respondents' complaint satisfied the four-part test identified in *Grable*, 545 U.S. at 314, for establishing federal-question jurisdiction under § 1331. Pet. App. 12a.

tions promulgated under that Act, and of "all suits in equity and actions at law brought to enforce any liability or duty created by" the Act or its regulations. 15 U.S.C. § 78aa(a). Under that language, federal courts have exclusive jurisdiction over a complaint that asserts a violation of the Exchange Act or its regulations as a basis for liability, or seeks judicial enforcement of the duties prescribed by the Act or its regulations. As both lower courts concluded and as respondents did not dispute, respondents' complaint repeatedly alleges that petitioners violated Regulation SHO, a regulation promulgated under the Exchange Act. Those allegations suffice to confer federal jurisdiction under the statute's plain text.

B. Section 27's stated purpose compels enforcement of its plain text. The statute was enacted principally to ensure that the Exchange Act and Exchange Act regulations would be uniformly interpreted by expert federal courts, and not by the courts of 50 different states lacking expertise in applying federal securities laws.

Expert federal adjudication is particularly crucial when, as here, the relevant regulatory scheme incorporates the SEC's careful balancing of technical and complex policy questions. Congress specifically sought to keep such cases in federal court to ensure that Exchange Act questions would be resolved by judges attuned to the national concerns underlying the Exchange Act and SEC regulations enforcing that Act.

II. The Third Circuit ignored § 27's text and purposes and held that § 27 does not grant jurisdiction at all, but instead merely deprives state courts

of jurisdiction when federal jurisdiction would exist under another provision, such as § 1331. That construction is incorrect.

A. The Third Circuit's position is incompatible with the statute's plain text. Section 27 says that federal courts "shall have exclusive jurisdiction" over cases that fall within its scope. Those words can only be read as conferring jurisdiction. In fact, Congress routinely uses the "shall have jurisdiction" formulation in jurisdictional grants throughout the U.S. Code. Adding the word "exclusive" does nothing to alter the provision's jurisdiction-conferring character.

B. The court of appeals' position is also inconsistent with the jurisdictional scheme that existed when § 27 was enacted. In 1934 (and until 1980), the general federal-question statute, now codified in § 1331, contained an amount-in-controversy requirement. This Court has held that § 22 of the Securities Act, the relevant language of which matches the language of § 27, had the effect of granting federal jurisdiction even when the requirements of § 1331 were not satisfied. The same result must apply to § 27, which definitively precludes the Third Circuit's reading.

C. The Third Circuit's position is also contrary to this Court's cases addressing § 27 itself, which have repeatedly described the provision as an affirmative grant of federal jurisdiction. *See Morrison v. Nat'l Austl. Bank Ltd.*, 561 U.S. 247, 254 (2010); *Touche Ross & Co. v. Redington*, 442 U.S. 560, 577 (1979); *J.I. Case Co. v. Borak*, 377 U.S. 426, 431 (1964).

D. The court of appeals' contrary conclusion was based on its misreading of this Court's opinion in *Pan American*, which interpreted § 22 of the Natural Gas Act ("NGA"), a provision nearly identical to § 27. The complaint in *Pan American* alleged state-law contract claims; the NGA was raised only as a *defense* to those state-law causes of action. This Court held that under what later became known as the "well-pleaded complaint" rule, § 22 grants jurisdiction only when the basis for jurisdiction appears on the face of the plaintiff's complaint. *Pan American* does not hold or suggest that § 22 does not confer jurisdiction *at all*.

III. In their opposition to certiorari, respondents argued that while § 27 itself may grant federal jurisdiction, the jurisdiction it grants is identical to § 1331. That construction is also incorrect—the two statutes have materially different language with materially different objectives.

Section 27 sets forth a clear and easily administrable jurisdictional rule: federal courts have exclusive jurisdiction when a complaint alleges "violations of" the Exchange Act or its regulations, or seeks to "enforce any liability or duty created by" that Act or those regulations. There is thus no need to adopt a complicated, atextual test to apply that language.

There is, by contrast, a need to apply that kind of test in construing § 1331, because that statute broadly establishes jurisdiction for any suit that "arises under" federal law—language that, read literally, would grant federal jurisdiction whenever "a federal question is 'an ingredient' of the action."

Merrell Dow Pharm. Inc. v. Thompson, 478 U.S. 804, 807 (1986) (quoting *Osborn v. Bank of the United States*, 22 U.S. (9 Wheat.) 738, 823 (1824)). For policy reasons specific to § 1331, this Court has declined to read that language so literally and has instead significantly narrowed its reach. To avoid the likelihood that federal courts will be overrun with cases that can be adjudicated just as well in state court, this Court has held that federal jurisdiction attaches under § 1331 only if (among other things) the federal question is "*necessarily* raise[d]" in the complaint and is "actually disputed and substantial." *Grable*, 545 U.S. at 314 (emphasis added).

Those concerns do not apply in the context of § 27, which is by its terms limited to a very narrow set of cases—those in which the complaint alleges a violation of, or seeks to enforce a duty under, the Exchange Act (without regard to whether those allegations would independently suffice to establish jurisdiction under § 1331). And the core purpose of § 27 was to ensure that such cases are adjudicated exclusively by federal courts, in marked contrast to the background presumption of § 1331 that state and federal courts are equally competent to resolve federal questions.

Congress has used the term "arising under" as a term of art in many jurisdictional grants other than § 1331, and this Court has assumed that when that language appears in other statutes, it incorporates this Court's construction of § 1331. But equally significant is Congress's decision not to use that ubiquitous terminology in § 27. That decision makes clear that Congress did not intend to adopt this Court's

construction of § 1331 and instead chose different and more precise language to establish a different and more precise jurisdictional test. Respecting Congress's plenary authority to establish federal courts' jurisdiction requires enforcing the plain language Congress enacted to establish jurisdiction under § 27.

ARGUMENT

Respondents' complaint on its face alleges violations of Regulation SHO in name and substance as a basis for state-law liability, and it seeks to enforce duties created by the Regulation. The district court thus had jurisdiction over this case under the plain terms of Exchange Act § 27, 15 U.S.C. § 78aa(a).

The Third Circuit and respondents resist that conclusion, articulating different reasons. In the Third Circuit's view, § 27 is not a grant of jurisdiction at all. In respondents' view, § 27 does grant jurisdiction, but only the *same* jurisdiction that is conferred by § 1331. Both positions are incorrect.

I. SECTION 27 CONFERS EXCLUSIVE FEDERAL JURISDICTION OVER RESPONDENTS' COMPLAINT

A. The Plain Terms Of § 27 Grant Exclusive Federal Jurisdiction Over The Complaint Because It Seeks To Establish A Violation Of Regulation SHO And To Enforce Duties Created By Regulation SHO

Section 27 states that the federal district courts "shall have exclusive jurisdiction of violations of [the

Exchange Act] or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by [the Act] or the rules and regulations thereunder." 15 U.S.C. § 78aa(a). Because respondents' complaint unambiguously asserts violations of Regulation SHO as a basis for liability and seeks to enforce the duties created by Regulation SHO, federal courts have exclusive jurisdiction over the complaint under § 27.

As both courts below recognized, respondents repeatedly allege that petitioners violated Regulation SHO—and especially that regulation's "locate" and "close-out" requirements—when engaging in short sales of Escala stock. For example, respondents allege that petitioners:

- Engaged in "intentional and persistent violation of rules and regulations governing unlawful naked short sales of securities." Pet. App. 44a.
- Violated "regulatory prohibitions barring the practice of naked short selling of stock." Pet. App. 81a.
- Engaged in "manipulation of the market" by "entering millions of proprietary and customer short sale transactions" without "reasonable grounds to believe that the securities could be borrowed and be available for delivery," Pet. App. 44a—an almost verbatim recitation of the conduct Regulation SHO's locate requirement prohibits, *see* 17 C.F.R. § 242.203(b)(1)(ii) (broker or dealer must have "[r]easonable grounds to believe that the secu-

rity can be borrowed so that it can be delivered on the date delivery is due").

- Sold "Escala stock short at times when [petitioners] neither possessed nor intended to obtain Escala stock to deliver by the Settlement Date," Pet. App. 85a, 88a, contrary to Regulation SHO's locate requirement.
- Violated Regulation SHO's "close-out" requirement by "permitt[ing] [fail-to-deliver] transactions to remain unfulfilled." Pet. App. 59a; *see* 17 C.F.R. § 242.203(b)(3) (requiring broker-dealers to "close out the fail to deliver position by purchasing securities of like kind and quantity" within set number of days).
- Engaged in conduct FINRA explicitly alleged to be a violation of Regulation SHO. *See supra* at 10 & n.5.

Those allegations fall squarely within the plain terms of § 27. Respondents allege "violations of [the Exchange Act] or the rules and regulations thereunder," 15 U.S.C. § 78aa(a), because they repeatedly allege that petitioners violated Regulation SHO. The complaint also seeks "to enforce . . . dut[ies] created by [the Act] or the rules and regulations thereunder," *id.*, because respondents' complaint seeks to hold petitioners liable for violating the "locate" and "close-out" duties of Regulation SHO. The fact that respondents seek to enforce those duties through state-law causes of action does not matter, because the statute applies broadly to "*all* suits in equity and actions at law brought to enforce" duties created by the Exchange Act or its regulations. *Id.* (emphasis

added). Section 27 by its express terms thus grants federal courts exclusive jurisdiction over respondents' complaint.

To be clear, nothing in § 27's language states or suggests that jurisdiction attaches only if the Regulation SHO violations and duties alleged in the complaint are *necessary* elements of respondents' claims. The language instead provides that when a violation or duty of the Act or its regulations is *asserted*, a federal court is the only court that can decide whether the alleged violation occurred or the duty was breached. It is accordingly irrelevant that other grounds also may provide a basis for liability—§ 27's text bars a state court from even considering whether the asserted violation occurred or the asserted duty was breached, because those matters are subject to the exclusive jurisdiction of the federal court. The presence of those allegations in a state-court complaint justifies removal, even if the complaint also asserts other possible bases for liability. *Cf. City of Chi. v. Int'l Coll. of Surgeons*, 522 U.S. 156, 164-65 (1997) (once removability of one or more claims is established, federal court assumes supplemental jurisdiction over otherwise non-removable claims pursuant to 28 U.S.C. § 1367).[7]

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[7] A perfect (and common) example is a state-law RICO claim alleging an Exchange Act violation among other predicate acts. Several district courts have incorrectly remanded such cases, leaving adjudication of the predicate Exchange Act violation to the state courts in direct contravention of § 27. *See, e.g., Raser Techs., Inc. v. Morgan Stanley & Co.*, 2012 U.S. Dist. LEXIS 189029, at *4-5 (N.D. Ga. Oct. 30, 2012); *Fairfax Fin.*

The plain, unambiguous language of § 27 should be the end of the matter. It is true in any case that the Court's analysis "begins with the language of the statute," and when "the statutory language provides a clear answer, it ends there as well." *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 438 (1999) (quotation omitted). But it is especially important to read § 27's text as written, given the settled "rule favoring clear boundaries in the interpretation of jurisdictional statutes." *Direct Mktg. Ass'n v. Brohl*, 135 S. Ct. 1124, 1131 (2015). "Simple jurisdictional rules . . . promote greater predictability," which is "valuable to corporations making business and investment decisions." *Hertz Corp. v. Friend*, 559 U.S. 77, 94 (2010). The plain text of § 27 provides a simple rule with clear boundaries: if the complaint on its face asserts a violation of the Act or its regulations or seeks to enforce a duty thereunder, the complaint is subject to the exclusive jurisdiction of the federal courts.

B. Section 27's Purposes Confirm The Exclusive Federal Jurisdiction Over Respondents' Complaint

Section 27's purposes confirm the plain meaning of its text. The Exchange Act is not just another federal law subject to the usual principles of jurisdiction. It was enacted to "protect[] the integrity and efficient operation of the market for nationally traded securities," and the "magnitude of the federal interest" in such matters "cannot be overstated." *Mer-*

Holdings, Ltd. v. S.A.C. Capital Mgmt., LLC, 2007 WL 1456204, at *5 (D.N.J. May 15, 2007).

rill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 78 (2006). Congress included § 27 in the Act specifically to protect the uniquely federal interests underlying the Act by promoting "greater uniformity of construction and more effective and expert application of" the Act and its regulations. *Matsushita*, 516 U.S. at 383 (quotation omitted); *see Murphy v. Gallagher*, 761 F.2d 878, 885 (2d Cir. 1985) ("Exclusive federal jurisdiction over violations of the 1934 Act was motivated by a desire to achieve greater uniformity of construction and more effective and expert application of that law.").

Allowing respondents' complaint to proceed in state court would contravene those statutory objectives as much as it would the statutory text. In *Matsushita*, this Court held that it would be consistent with § 27's uniformity objective for a state court to approve a settlement that released Exchange Act claims "because the state court does not adjudicate the Exchange Act claims," but instead merely "evaluates the overall fairness of the settlement." 516 U.S. at 383. The opposite is true here: the state court is specifically being asked to determine whether petitioners violated an Exchange Act regulation, which would permit—indeed, require—*every* state court faced with a similar complaint to interpret the meaning and scope of Exchange Act regulations. Accordingly, there is here (unlike in *Matsushita*) a real "danger that state-court judges who are not fully expert in federal securities law will say definitively what the Exchange Act [or Exchange Act regulations] mean[] and enforce legal liabilities and duties thereunder." *Id.* That is, after all, exact-

ly what respondents want the New Jersey courts to do.

Subjecting federal rights and issues to state-court adjudication will always "decrease uniformity—and therefore predictability—in the[ir] development." Martin H. Redish & John E. Muench, Adjudication of Federal Causes of Action in State Court, 75 Mich. L. Rev. 311, 312 (1976). But as *Matsushita* recognizes, the "danger" of non-expert adjudication is especially acute for highly technical and complex securities regulations like Regulation SHO.[8] Expert federal courts are crucial in this context not only because they are experienced in interpreting federal statutes and regulations, but because they are "sensitive to the national concerns underlying them." *Will v. Calvert Fire Ins. Co.*, 437 U.S. 655, 670 (1978) (Brennan, J., dissenting). Cases (like this one) implicating the SEC's regulation of short selling on na-

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[8] A decision exemplifying the problems with state-court adjudication of Exchange Act questions is *Overstock.Com, Inc. v. Goldman Sachs & Co.*, No. A135682 (Cal. App. Nov. 13, 2014), http://appellatecases.courtinfo.ca.gov/search/case/mainCaseScreen.cfm?dist=1&doc_id=2016756&doc_no=A135682. The state court in that case accepted jurisdiction over a complaint asserting violations of Regulation SHO as the basis for state-law liability and, after discussing at length the substance of the Regulation, slip op. 9-10, held that a state-court jury must decide whether certain parties were engaged in "bona fide market making" as required by Regulation SHO—a term the SEC itself has not defined—and whether the defendant's delegation of delivery obligations to others was "reasonable," again as required by Regulation SHO, 17 C.F.R. § 242.203(b)(2). *See* slip op. 49-50. The whole point of § 27 is to ensure that such difficult questions concerning the scope of Exchange Act regulations are resolved by federal courts.

tional exchanges provide a perfect example of why a federal adjudicator "sensitive to the national concerns" underlying those regulations is so crucial.

On respondents' telling, a "naked" short sale—i.e., a short sale where the "seller does not own, and does not borrow or arrange to borrow the securities in time to make delivery to the buyer"—results in the creation of "counterfeit shares," or "fictitious and/or phantom share[s] of stock." Pet. App. 50a-51a. Respondents invoke this inflammatory language to create for non-expert state judges and jurors the impression that the conduct at issue is inherently deceitful and harmful.

But the SEC itself has explicitly rejected the misleading narrative the complaint seeks to articulate. Naked short sales do not create "phantom" or "counterfeit" shares, the SEC has explained, because such sales have "no effect on an issuer's total shares outstanding." SEC, Division of Market Regulation: Responses to Frequently Asked Questions Concerning Regulation SHO.[9] The SEC likewise has emphasized that naked short selling "is not necessarily a violation of the federal securities laws or the Commission's rules," but actually is beneficial when it "contributes to market liquidity." *Id.* And facilitating the liquidity-promoting benefits of naked short selling is precisely why the SEC has determined that Regulation SHO's locate requirement does not apply to market makers engaged in "bona fide market-

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[9] *Available at* https://www.sec.gov/divisions/marketreg/mrfaqregsho1204.htm.

making activities," *see supra* at 7-8, which includes many petitioners here.

Congress specifically restricted jurisdiction over cases like this to federal courts because adjudicating suits seeking to establish violations of regulations like Regulation SHO—in which the SEC has carefully weighed (and continues to weigh) the costs and benefits of certain trading practices to arrive at a properly balanced solution—requires expert *federal* decisionmakers well-versed in interpreting and applying federal regulatory schemes, with particular sensitivity to the uniquely national interests balanced in those schemes.

State courts, of course, are considered competent to decide most questions of federal law. *See Tafflin v. Levitt*, 493 U.S. 455, 458 (1990); *Claflin v. Houseman*, 93 U.S. 130, 136-37 (1876). But not all such questions. In a limited set of circumstances, Congress has concluded that state courts are not well-equipped to conduct the careful application of the sensitive federal interests raised and has committed such cases exclusively to the jurisdiction of federal courts.[10] This is such a case. Because the complaint on its face unambiguously asks a court to apply the Exchange Act and its regulations to petitioners' conduct, the complaint must be adjudicated in federal court.

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[10] Other grants of exclusive federal jurisdiction include, for example, 15 U.S.C. § 717u (Natural Gas Act); 18 U.S.C. § 2338 (Anti-Terrorism Act); 29 U.S.C. § 1132 (ERISA); 28 U.S.C. § 1333 (admiralty); and 28 U.S.C. § 1334 (bankruptcy).

II. CONTRARY TO THE COURT OF APPEALS' HOLDING, § 27 IS AN INDEPENDENT GRANT OF JURISDICTION

Rejecting the straightforward analysis set forth above, the Third Circuit held that § 27 does not grant jurisdiction at all, but "merely serves to divest state courts of jurisdiction" that might otherwise exist under § 1331 and therefore "does not provide an independent basis to exercise jurisdiction over [respondents'] claims." Pet. App. 22a. That holding is demonstrably incorrect.

A. The Text Of § 27 Plainly Confers Jurisdiction

Section 27 states that the federal courts "shall have exclusive jurisdiction" of suits alleging violations of the Exchange Act or regulations promulgated under that Act, or seeking to enforce liabilities or duties created by that Act or those regulations. 15 U.S.C. § 78aa(a). That language is an unambiguous grant of jurisdiction. Congress frequently uses the phrase "shall have jurisdiction" to create federal jurisdiction—indeed, that phrase cannot reasonably be construed any other way. *Compare* 28 U.S.C. § 1291 ("The courts of appeals . . . shall have jurisdiction of appeals from all final decisions of the district courts of the United States . . . except where a direct review may be had in the Supreme Court."), *with Gelboim v. Bank of Am. Corp.*, 135 S. Ct. 897, 902 (2015) ("Section 1291 gives the courts of appeals jurisdiction over

appeals from 'all final decisions of the district courts of the United States.'").[11]

The only difference between § 27 and these other provisions is that § 27 includes the modifier "exclusive." According to the Third Circuit's analysis, the word "exclusive" somehow *undoes* the grant of federal jurisdiction achieved by the phrase "shall have jurisdiction." But if anything, adding the word "exclusive" merely underscores Congress's strong interest in ensuring federal-court supervision over claims that fall within the provision's scope—not only are such claims subject to federal jurisdiction, they are subject *only* to federal jurisdiction.

B. The Context Of § 27's Enactment Confirms That It Is A Jurisdictional Statute

The context in which § 27 was enacted confirms the obvious meaning of its text. At the time the Exchange Act was adopted, the general federal-question jurisdiction provision (now codified at 28 U.S.C. § 1331) included an amount-in-controversy requirement, which was not eliminated until 1980.

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[11] *See also* 7 U.S.C. § 1642(e) ("The district courts of the United States shall have jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder."); 15 U.S.C. § 378(a) ("The United States district courts shall have jurisdiction to prevent and restrain violations of this chapter and to provide other appropriate injunctive or equitable relief, including money damages, for the violations."); 33 U.S.C. § 1232(d) ("The United States district courts shall have jurisdiction to restrain violations of this chapter or of regulations issued hereunder, for cause shown.").

See Arbaugh v. Y&H Corp., 546 U.S. 500, 506 (2006). Section 27, by contrast, never included any such requirement. If § 27 did not grant federal jurisdiction independent of § 1331, then any claim implicating the Exchange Act—even including a claim specifically pleading a cause of action under the Act—could not have been heard in federal district court unless the claim also satisfied § 1331's amount-in-controversy requirement.

This Court's precedents concerning an analogous provision in the Securities Act, however, make clear that federal courts *could* hear cases asserting Exchange Act claims, even when they did not satisfy § 1331. Section 22 of the Securities Act allows for concurrent state and federal jurisdiction, but its operative jurisdiction-conferring language matches § 27's: "The district courts of the United States and the United States courts of any Territory *shall have jurisdiction* . . . ." 15 U.S.C. § 77v(a) (emphasis added). That language, this Court has held, suffices *on its own terms* to "confer[] jurisdiction . . . upon the District Court irrespective of the amount in controversy" required to satisfy § 1331. *Deckert v. Independence Shares Corp.*, 311 U.S. 282, 289 (1940); *see Wilko v. Swan*, 346 U.S. 427, 431 (1953). The same conclusion necessarily applies under § 27: its materially identical jurisdictional language confers jurisdiction irrespective of whether § 1331's requirements are satisfied. Section 27, in other words, is a grant

of jurisdiction independent of § 1331, contrary to the Third Circuit's conclusion.[12]

C. This Court's Precedents Uniformly Describe § 27 As A Grant Of Jurisdiction

Consistent with § 27's text and context, this Court's precedents uniformly refer to § 27 as an independent jurisdictional grant. In *Morrison v. National Australia Bank Ltd.*, 561 U.S. 247 (2010), the Court held that the district court "had jurisdiction under [§ 27] to adjudicate the question whether § 10(b) applies to [the defendant's] conduct." *Id.* at 254. Similarly, in *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979), the Court observed that "Section 27 grants jurisdiction to the federal courts." *Id.* at 577. And in *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964), the Court stated that § 27 "specifically grants the appropriate District Courts jurisdiction over 'all suits in equity and actions at law brought to enforce any liability or duty created' under the Act." *Id.* at 431. None of these precedents suggests that § 1331 must be separately satisfied before federal jurisdiction attaches.

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[12] The fact that Congress enacted § 27 in part to avoid § 1331's amount in controversy requirement does not suggest that Congress otherwise intended to import the rest of § 1331's jurisdictional requirements. Had Congress so intended, it would have simply used § 1331's language while omitting the amount in controversy requirement. The fact that Congress used altogether different language demonstrates that Congress intended an altogether different test. *See infra* Part III.

D. *Pan American* Is Not To The Contrary

The Third Circuit's conclusion that § 27 does not itself create jurisdiction relied almost entirely on this Court's decision in *Pan American*. Pet. App. 19a-20a. The Third Circuit simply misread that decision (which no party had cited in briefing).

Pan American involved § 22 of the Natural Gas Act, which—as discussed above, *supra* at 13—has the same jurisdictional language as Exchange Act § 27. But unlike here, where respondents' complaint on its face both asserts violations of Regulation SHO and seeks to enforce duties created by Regulation SHO as a basis for state-law tort liability, the complaint in *Pan American* did not invoke or depend on any violation of federal law as the basis for state-law liability. 366 U.S. at 662-64. Instead, the plaintiff asserted only state-law breach-of-contract claims, and the NGA issues arose solely as a defense to the alleged contractual breaches. *See id.*

The defendant objected to state-court jurisdiction on the basis of NGA § 22's "exclusive jurisdiction" language, but this Court held—applying what later became known as the "well-pleaded complaint" rule—that federal jurisdiction attaches only when the federal issue appears on "the face of the complaint," regardless whether the "defendant is almost certain to raise a federal defense." *Id.* at 663. The "exclusive jurisdiction" language of NGA § 22 did not alter that long-settled rule, the Court explained: "'Exclusive jurisdiction' is given the federal courts but it is 'exclusive' only for suits that may be brought in the federal courts. Exclusiveness is a consequence of having jurisdiction, not the generator of jurisdic-

tion because of which state courts are excluded." *Id.* at 664.

The Third Circuit misread that passage to mean that an "exclusive jurisdiction" provision never creates federal jurisdiction—even when the complaint raises the precise issue subject to exclusive jurisdiction. *See* Pet. App. 20a. Read in context, however, the cited passage merely confirms that an "exclusive jurisdiction" provision does not overcome the long-settled rule requiring that jurisdiction be assessed from the face of a well-pleaded complaint, without regard to potential issues that may be raised solely in a defense. Indeed, that rule is reflected in the statutory language, under which exclusive federal jurisdiction turns on what is alleged in the complaint itself—i.e., "violations of" the NGA or "all suits in equity and actions at law *brought to enforce* any liability or duty created by" the NGA. 15 U.S.C. § 717u (emphasis added); *see id.* § 78aa(a) (same for Exchange Act).

Because respondents' complaint here on its face asserts violations of Regulation SHO as a basis for liability and seeks to enforce duties created by that regulation, the rule applied in *Pan American* creates no barrier to federal jurisdiction in this case.

III. CONTRARY TO RESPONDENTS' ARGUMENT, JURISDICTION UNDER § 27 IS NOT MERELY COEXTENSIVE WITH § 1331 "ARISING UNDER" JURISDICTION

In their opposition to certiorari, respondents argued that while § 27 may confer jurisdiction, the jurisdiction it grants just happens to coincide with the

jurisdiction separately granted—with completely different language—by the general federal-question statute, 28 U.S.C. § 1331. *See* Opp. 18 (§ 27 jurisdiction is "coextensive with, and not broader than, § 1331"); *see also Barbara v. N.Y. Stock Exch., Inc.*, 99 F.3d 49, 55 (2d Cir. 1996) (same). Respondents therefore argue that § 27 applies only to claims "arising under" the Exchange Act or its regulations, as that phrase has been interpreted in this Court's general federal-question jurisdiction jurisprudence. Opp. 17-18. That position is not only contrary to the text and purposes of § 27, it is also at odds with the language of § 1331 and the principles governing jurisdiction under that provision.

This Court of course "must not give jurisdictional statutes a more expansive interpretation than their text warrants, but it is just as important not to adopt an artificial construction that is narrower than what the text provides." *Exxon Mobil Corp. v. Allapattah Servs., Inc.*, 545 U.S. 546, 558 (2005) (citation omitted). As noted above, *supra* at 23, jurisdictional statutes in particular must be construed in accordance with the "rule favoring clear boundaries in the interpretation of jurisdictional statutes." *Brohl*, 135 S. Ct. at 1131.

The rule established by § 27's plain text could hardly be clearer: whether the complaint on its face asserts a violation of the Act or its regulations or seeks to enforce a duty thereunder. Given that simple, easily administrable statutory test, there is no need for a complicated, multi-factor-laden inquiry into whether the complaint is one that "arises under" the Exchange Act, as would be required if Congress

had employed the distinct, jurisdictional term-of-art language of § 1331. *See Grable*, 545 U.S. at 313-14.

The textual difference between the two statutes is a difference that matters. *Cf. Consumers Imp. Co. v. Zosenjo*, 320 U.S. 249, 253 (1943) (Congress "used different language here because it had a different purpose to accomplish"). In contrast to the clear and simple jurisdictional rule stated in § 27, § 1331 on its face broadly establishes "original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States." That broad language has never been construed according to its plain terms, but instead "has been continuously construed and limited in the light of the history that produced it, the demands of reason and coherence, and the dictates of sound judicial policy which have emerged from the [statute's] function as a provision in the mosaic of federal judiciary legislation." *Romero v. Int'l Terminal Operating Co.*, 358 U.S. 354, 379 (1959).

In particular, while § 1331's language mirrors the language in Article III of the Constitution, this Court has—for policy reasons unique to § 1331—always "construed the statutory grant of federal-question jurisdiction as conferring a more limited power." *Merrell Dow*, 478 U.S. at 807; *see Verlinden B.V. v. Cent. Bank of Nigeria*, 461 U.S. 480, 494-95 (1983). The central concern is that a natural reading of § 1331 would grant federal courts jurisdiction in "all cases in which a federal question is 'an ingredient' of the action," *Merrell Dow*, 478 U.S. at 807 (quoting *Osborn*, 22 U.S. (9 Wheat.) at 823), which would threaten to "swamp the lower federal courts,"

13D Charles Alan Wright, Arthur R. Miller, et al., Federal Practice & Procedure § 3562 (3d ed.). Accordingly, for jurisdiction to attach under § 1331, this Court has held that the federal question must not only be an "ingredient" of the action, it also must be "necessarily raise[d]" by the complaint and must be an "actually disputed and substantial" issue. *Grable*, 545 U.S. at 314.

None of the policy reasons justifying the narrow construction of § 1331 has anything to do with § 27. Accordingly, § 27 can be enforced according to its plain language, which does not limit jurisdiction to complaints that *necessarily* require adjudication of an Exchange Act issue. *See supra* at 22.

Concerns about overburdening federal courts do not apply to § 27. Those concerns arise in the context of § 1331 because it is "the catchall federal-question provision," *Mt. Healthy City Sch. Dist. Bd. of Educ. v. Doyle*, 429 U.S. 274, 279 (1977), but § 27 is directed to only a single, comparatively limited set of cases based on a single statute and its implementing regulations.

And for that small set of cases, Congress certainly was not concerned that *too many* would be heard in federal court—to the contrary, Congress wanted *all of them* to be heard in federal court. The background presumption underlying the narrow interpretation of § 1331 is that state courts are competent to resolve most federal questions. *See supra* at 27; *Gulf Offshore Co. v. Mobil Oil Corp.*, 453 U.S. 473, 478 (1981) (noting "the presumption that state courts enjoy concurrent jurisdiction"). But the *opposite* presumption applies under § 27, the very premise of

which is that state courts are not competent to adjudicate the meaning and application of the Exchange Act and its implementing regulations. *See supra* at 27. It would flip that presumption on its head to interpret § 27 as incorporating sub silentio the same narrow, complicated, and atextual jurisdictional inquiry this Court has read into § 1331 on the premise that state courts are an appropriate forum for resolving federal questions.

Although the phrase "arising under" has been construed narrowly for policy reasons specific to § 1331, the phrase long ago became a jurisdictional term of art Congress has invoked in multiple statutes, *see, e.g.*, 28 U.S.C. §§ 157, 1295, 1334, 1337, 1338, 1339, 1340, 1441, 1445, 1491, 1505, including in provisions enacted before the Exchange Act, *see, e.g.*, 28 U.S.C. § 41(4), (5), (6), (7), (8) (1934) (granting federal jurisdiction over actions "arising under" "any law related to the slave trade," "any law providing for internal revenue," "the postal laws," "the patent, the copyright, and the trademark laws," and "any law regulating commerce"). These other statutes are read to be coextensive with § 1331 for sound reasons of "[l]inguistic consistency," *Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 808 (1988), and Congress's use of that term-of-art phrase "is strong evidence that Congress intended to borrow the body of decisional law that has developed under 28 U.S.C. § 1331 and other grants of jurisdiction to the district courts over cases 'arising under' various regulatory statutes," *Coastal States Mktg., Inc. v. New England Petroleum Corp.*, 604 F.2d 179, 183 (2d Cir. 1979) (quoted in *Holmes Grp., Inc. v.*

Vornado Air Circulation Sys., Inc., 535 U.S. 826, 833 (2002)); *see Christianson*, 486 U.S. at 808.

Congress's conspicuous decision not to use § 1331's "arising under" formulation in § 27, by contrast, is equally strong evidence that Congress did not intend to incorporate the body of law narrowly construing that phrase, but intended the different and more precise language of § 27 to establish a different and more precise jurisdictional test. As the Court has emphasized, "the many limitations which have been placed on jurisdiction under § 1331 are not limitations on the constitutional power of Congress to confer jurisdiction on the federal courts." *Romero*, 358 U.S. at 379 n.51. Congress has the exclusive and plenary authority to determine the jurisdiction of lower federal courts, *see* U.S. Const. art. III, § 1; *Cary v. Curtis*, 44 U.S. 236, 245 (1845), and when Congress rejects the ubiquitous "arising under" formulation and uses different language establishing a distinct jurisdictional test, courts must respect and enforce that decision.

Finally, there is no merit to respondents' suggestion that this Court in *Pan American* categorically equated the jurisdictional language used in § 27 with the distinct term-of-art phrase "arising under." In opposing certiorari, respondents cited dictum in a footnote observing that jurisdiction under the NGA was *implicitly* limited to cases "'arising under' the Natural Gas Act." 366 U.S. at 665 n.2. That dictum, however, was relevant only to the Court's invocation of the well-pleaded complaint rule, which has no application here. *See supra* at 33. The Court's statement also was not based on the distinct language of

§ 22, but solely on legislative history specific to the NGA. *See* 366 U.S. at 665 n.2. (citing "authoritative Committee Reports"). The footnote, in fact, specifically acknowledges that § 22's *language* does not incorporate the limitations of "arising under" jurisdiction. *Id.* Section 27 includes no comparable legislative history suggesting that a similar implied limitation should be read into its broad language. *See Matsushita*, 516 U.S. at 383. And in any event, it may have made sense at the time to say that NGA § 22 was coextensive with § 1331, but that equivalence no longer holds. When *Pan American* was decided, "arising under" jurisdiction was defined more broadly than it is now, and encompassed *any* claim that "depends upon the construction or application" of federal law, so long as the federal claim was "not merely colorable." *Smith v. Kansas City Title & Trust Co.*, 255 U.S. 180, 199 (1921). But since *Pan American* was decided, "arising under" jurisdiction has been scaled back substantially. *See Grable*, 545 U.S. at 312-13 (*Smith*'s "generous statement of the scope" of federal-question jurisdiction "has been subject to some trimming"). The question today is whether the distinct language of § 27 must be construed as incorporating the limitations that have been read into the particular language of § 1331 for policy reasons specific to that statute. The answer plainly is no, as this brief has shown.

CONCLUSION

For the foregoing reasons, the decision below should be reversed.

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September 3, 2015

Supreme Court, U.S.
FILED
SEP 10 2015
OFFICE OF THE CLERK

No. 14-1132

In the Supreme Court of the United States

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., ET AL.,
PETITIONERS,

v.

GREG MANNING, ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

BRIEF FOR THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

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BRIEF FOR THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION AS AMICUS CURIAE SUPPORTING PETITIONERS

INTEREST OF AMICUS CURIAE

SIFMA brings together the shared interests of more than 650 securities firms, banks, and asset managers. Its mission is to support a strong financial industry, investor opportunity, capital formation, job creation, and economic growth, while building trust and confidence in the financial markets. With offices in New York and Washington, D.C., SIFMA is the U.S. regional member of the Global Financial Markets Association.*

SIFMA has a unique perspective on this case. Many of its members are financial institutions subject to the Securities Exchange Act of 1934, 48 Stat. 881, 15 U.S.C. 78a *et seq.* This case concerns the interpretation of Section 27 of that Act, which grants exclusive jurisdiction to federal courts over Exchange Act violations. As both regulated entities and litigants in this area, SIFMA's members have a substantial interest in the meaning and scope of that provision. The decision below, if allowed to stand, would enable various state courts to establish competing interpretations of Exchange Act regulations under the guise of state law, in turn imposing different (and potentially conflicting)

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* Pursuant to Rule 37.6, SIFMA affirms that no counsel for a party authored this brief in whole or in part, and that no person other than amicus or its counsel contributed any money to fund its preparation or submission. All parties have filed letters with the Court granting blanket consent to the filing of amicus briefs.

obligations on SIFMA's members. Accordingly, SIFMA has a significant interest in the Court's resolution of this case.

SUMMARY OF ARGUMENT

I. A. The decision below is inconsistent with Section 27's plain text, which provides that federal courts "shall have exclusive jurisdiction" over "violations" of the Act and over "all suits * * * brought to enforce any liability or duty created by [the Act] or the rules and regulations thereunder." 15 U.S.C. 78aa(a). Congress could hardly have been clearer or used broader language. Suits that assert the violation of a duty imposed by the Exchange Act or its accompanying regulations must be brought in federal court, even if plaintiffs nominally cloak their claims in state-law garb. Here, "[t]here is no question that [respondents] assert in their Amended Complaint, both expressly and by implication, that [petitioners] repeatedly violated federal law." Pet. App. 9a. Because plaintiffs have elected to premise their state-law claims on violations of the Exchange Act and its implementing regulations, there is exclusive federal jurisdiction over this case under Section 27.

B. The court of appeals based its contrary conclusion not on the text of Section 27, but on this Court's decision in *Pan American Petroleum Corp.* v. *Superior Court of Delaware*, 366 U.S. 656 (1961) (*Pan American*). See Pet. App. 19a-20a. In *Pan American*, this Court held that, when a plaintiff pleads purely state-law claims, a federal exclusive-jurisdiction provision does not bring the case into federal court based on federal defenses. Whether an exclusive-jurisdiction provision trumps a plaintiff's mastery of its own complaint and the well-pleaded complaint rule has no rel-

evance when, as here, a plaintiff pleads claims necessarily predicated on violations of federal law. The Court in *Pan American* correctly recognized that the term "exclusive" is not itself a generator of jurisdiction, but here what generates jurisdiction is the operative language of Section 27 that follows the term "exclusive": the language that confers jurisdiction over all violations of, and all suits brought to enforce, the Act and its implementing regulations.

II. A. The decision below defeats Section 27's intended purpose of achieving "greater uniformity of construction and more effective and expert application of" the Exchange Act. *Matsushita Elec. Indus. Co., Ltd.* v. *Epstein*, 516 U.S. 367, 383 (1996). Such uniformity is uniquely important to the Exchange Act. Unlike the Securities Act of 1933, which focuses on disclosures made as part of individual securities offerings (and permits state courts to exercise concurrent jurisdiction over certain non-class claims), the Exchange Act was intended to "remove impediments to and perfect the mechanisms of a *national market* system for securities." 15 U.S.C. 78b (emphasis added). As part of guaranteeing that participants in the financial markets are governed by national standards, Section 27's grant of exclusive federal jurisdiction ensures that "binding legal determinations of rights and liabilities under the Exchange Act are for federal courts only." *Matsushita*, 516 U.S. at 384.

B. Uniformity in the interpretation of the Exchange Act is critical to a number of important federal policies and interests, including the need for certainty and predictability in the financial markets. On respondents' approach, market participants would be forced to contend with interpretations of the Exchange Act and its regulations by numerous state

courts under a patchwork of many States' laws. That would undermine consistency in the rules governing trade settlement and clearing of securities transactions on the national exchanges, including here as to short selling, a common practice that facilitates both market liquidity and pricing efficiency. The resulting uncertainty would disrupt standard industry practices that allow millions of securities and commodities transactions to be processed quickly and cheaply every day. Securities clearing firms would either raise costs or reduce clearing operations, which would lessen market liquidity and impair short sale activity.

C. Finally, allowing state courts to implement varying interpretations of federal standards would encourage litigants to engage in forum shopping. Plaintiffs already have begun shifting their cases to state courts because of a lack of success on short selling claims brought in federal courts under the federal securities laws. And as this case shows, plaintiffs are further motivated to dress up Exchange Act claims in state law garb in an effort to avoid federal pleading standards and take advantage of state RICO statutes, which allow types of relief that are normally unavailable under the Exchange Act—namely, treble damages and attorney's fees. Those efforts will only multiply as the number of suits alleging Regulation SHO violations increases.

ARGUMENT

The court of appeals held that Section 27 does not confer on federal courts any form of original jurisdiction over claims predicated on Exchange Act violations. See Pet. App. 22a (Section 27 "is coextensive" with Section 1331, "merely serves to divest state courts of jurisdiction," and "does not provide an independent basis to exercise jurisdiction."). The court of appeals' decision is inconsistent with the plain text and policies underlying Section 27, and this Court therefore should reverse the judgment below.

I. THE DECISION BELOW IS INCONSISTENT WITH THE PLAIN TEXT OF SECTION 27.

A. Section 27 Grants Jurisdiction Over Suits Such As This One That Assert Violations Of, Or Are Brought To Enforce Duties Under, Regulation SHO.

1. In this case, respondents contend that petitioners engaged in "unlawful naked short selling" of stock. Pet. App. 44a, 55a, 61a. What makes that conduct unlawful in respondents' view is federal law. Their complaint repeatedly and expressly references federal law, in addition to incorporating standards of conduct located exclusively in federal regulations. See, *e.g.*, *id.* at 44a, 49a, 51a, 52a-54a, 55a, 59a. The reason for that is simple: the Securities and Exchange Commission has placed restrictions on broker-dealers that settle and clear short sales by promulgating Regulation SHO, 17 C.F.R. 242.200 *et seq.* There is no analogue to Regulation SHO in the State of New Jersey. See Pet. App. 9a.

Despite the fact that respondents base their claims on federal law—*i.e.*, Regulation SHO—they have as-

serted those claims under the guise of New Jersey statutory and common law, seemingly in an effort to avoid federal pleading standards and obtain treble damages under New Jersey's RICO statute. See Pet. App. 45a (explaining that respondents sought treble damages below). In other words, respondents seek to turn alleged violations of Regulation SHO into state-law claims by arguing that, because state law supposedly mirrors or incorporates federal law, petitioners violated state law when they engaged in conduct that violates federal law. As both courts below concluded, "[t]here is no question that [respondents] assert in their Amended Complaint, both expressly and by implication, that Defendants repeatedly violated federal law"—namely, Regulation SHO. Pet. App. 9a; see *id.* at 29a ("Notably, [respondents] do not dispute that the alleged unlawful conduct is predicated on a violation of Regulation SHO, 17 C.F.R. § 242.204.").

2. Respondents' own allegations should end the jurisdictional analysis. Section 27 of the Exchange Act vests federal courts with "exclusive jurisdiction of *violations of* [the Act] or the rules and *regulations* thereunder, and of *all suits* * * * *brought to enforce any liability or duty created by* [the Act] or the rules and *regulations* thereunder." 15 U.S.C. 78aa(a) (emphases added). Section 27 thus provides federal courts with exclusive jurisdiction over any action that asserts a violation of, or that is brought to enforce a liability or duty created by, the Exchange Act and its implementing regulations. The present case falls squarely within both categories.

a. On its face, respondents' complaint expressly alleges that petitioners "repeatedly violated federal law" in the form of Regulation SHO. Pet. App. 9a. In Section 27, Congress provided jurisdiction over all

"violations" of the Act and its implementing regulations. 15 U.S.C. 78aa(a). That language is not limited to criminal violations. Indeed, with respect to venue, Section 27 uses the term "violation" to refer not only to criminal proceedings, but also to civil actions for injunctive relief. See *id.* (providing for venue in "[a]ny suit or action * * * to enjoin any violation" of the Exchange Act or its implementing regulations). By its terms, the first clause of Section 27—the violations clause—extends to suits that, whether or not pleaded under the Exchange Act, are predicated on alleged violations of the Act. Respondents' suit plainly meets that test.

b. But even assuming this Court were inclined to read Section 27's first clause narrowly, that still would not justify the decision below. This action is brought to "enforce" a "duty" created by a regulation promulgated under the Exchange Act (Regulation SHO), even if the mechanism for enforcing that duty is a state-law cause of action that incorporates the federal standard. The court of appeals effectively read Section 27's second clause to apply only to suits that arise under the Exchange Act for purposes of federal-question jurisdiction under 28 U.S.C. 1331. But the language of Section 27 is much broader: it extends to "all suits" intended to enforce federal duties created by the Exchange Act or its implementing regulations, regardless of whether those suits are pleaded under federal or state law. The court of appeals' reasoning drains Section 27's second clause of any independent content.

Moreover, if Congress had intended Section 27 to apply only to suits arising under the Exchange Act for purposes of Section 1331, it would have said so. By 1934 when the Exchange Act was enacted, Congress

had frequently used the phrase "arising under" to confer jurisdiction on federal courts. Pet. Br. 37. Indeed, the same Congress that enacted the Exchange Act employed that term of art to confer jurisdiction in another statute. See Act of June 18, 1934, Ch. 568 Sec. 1, Pub. L. No. 73-375, 48 Stat. 979 ("That jurisdiction be, and is hereby, conferred upon the Court of Claims * * * to hear, examine, and adjudicate and render judgment in any and all legal and equitable claims *arising under* or growing out of the Act of January 14, 1889.") (emphasis added). Respondents ignore Congress's decision instead to use broader language in Section 27.

B. This Court's Decision in *Pan American* Does Not Compel A Different Result.

1. The court of appeals did not address the text of Section 27, holding instead that its ruling was controlled by this Court's decision in *Pan American Petroleum Corp.* v. *Superior Court of Delaware*, 366 U.S. 656 (1961) (*Pan American*). See Pet. App. 19a-20a. There is a reason respondents neither cited nor briefed *Pan American* below: it is fundamentally a contract case. The plaintiff in *Pan American* pleaded only state-law claims and made no attempt to invoke federal law. See 366 U.S. at 662-663 ("No right is asserted under the Natural Gas Act."). The Court held that, when a plaintiff pleads purely state-law claims, a similarly worded exclusive-jurisdiction provision in the Natural Gas Act (NGA), 15 U.S.C. 717(u), does not grant federal jurisdiction. But that holding has no bearing when, as here, a plaintiff pleads claims that expressly incorporate and rely on federal law.

In *Pan American*, a pipeline company paid more for natural gas than its contracts required because of

a pending state regulatory order. The company notified its suppliers that it had challenged the order and that it expected repayment in the event the order was lifted. See 366 U.S. at 658-659. The suppliers accepted payment subject to those conditions. See *ibid.* When this Court set aside the order, the pipeline company brought suit on its contracts in state court. The company pointed to the fact that its suppliers had agreed (or had not objected) to repayment in the event the state regulatory order was held invalid. See *id.* at 661. The suppliers, however, claimed that the case had to be heard in federal court in part because of the NGA's exclusive-jurisdiction provision. See *id.* at 661-662.

This Court disagreed for the obvious reason that although the plaintiff in *Pan American* could have pursued a federal filed-rate claim under the NGA, it had elected to pursue solely common-law claims. See 366 U.S. at 662 ("[T]he complaints in the Delaware Superior Court * * * demand recovery on alleged contracts to refund overpayments * * * or for restitution of the overpayments."); *id.* at 663 ("The rights as asserted by Cities Service are traditional common-law claims."). The Court recognized that federal issues could arise only by way of the suppliers' defenses, see *id.* at 662-663, and it therefore rejected federal jurisdiction under what is now commonly known as the well-pleaded complaint rule. See *id.* at 663 (citing, *e.g.*, *Skelly Oil Co.* v. *Phillips Petroleum Co.*, 339 U.S. 667, 672 (1950)).

In *Pan American*, the plaintiff was not invoking federal law, either directly or indirectly. Here, by contrast, respondents have not asserted an independent, freestanding state-law claim. Only by invoking federal standards of conduct (namely, Regulation

SHO) do they manage to assert a claim at all. Indeed, their complaint repeatedly borrows the language of, and directly refers to, Regulation SHO. Respondents are the masters of their own complaint, see *The Fair* v. *Kohler Die & Specialty Co.*, 228 U.S. 22, 25 (1913) ("[T]he party who brings a suit is master to decide what law he will rely upon."), and they elected to allege violations of the Exchange Act and Regulation SHO as the basis for their state-law claims. That conscious choice brings them squarely within the language of Section 27.

2. To be sure, the Court in *Pan American* recited the truism that exclusive jurisdiction is "'exclusive' only for suits that may be brought in the federal courts. Exclusiveness is a consequence of having jurisdiction, not the generator of jurisdiction." 366 U.S. at 664. In context, the *Pan American* Court was responding to the suppliers' argument that the NGA's exclusive-jurisdiction provision pulled the case into federal court based on their federal defenses. The Court rejected the notion that an exclusive-jurisdiction provision overrides the well-pleaded complaint rule. In determining whether a case falls within a jurisdictional provision—whether concurrent or exclusive—what matters is the well-pleaded complaint, not any defenses to that complaint. See *id.* at 663-665.

The *Pan American* Court did not mean that an exclusive-jurisdiction provision can never be a grant of jurisdiction—*i.e.*, that an exclusive-jurisdiction provision can only divest state courts of concurrent jurisdiction over cases that are already in federal court. Whether an exclusive-jurisdiction provision confers jurisdiction (in addition to divesting state courts of jurisdiction) depends on whether its operative lan-

guage is broader than other jurisdictional statutes. Here, the text of Section 27 is broader than this Court's interpretation of Section 1331: Section 27 creates federal jurisdiction whenever a plaintiff complains of a violation of, or brings suit to enforce, the Act and its implementing regulations—regardless of whether the suit is pleaded under federal or state law. See Pet. Br. 34-39. The term "exclusive" then ensures that not only *may* such suits be brought in the federal courts, but they *must* be brought there. The term "exclusive" does not generate jurisdiction, as the *Pan American* Court recognized. What generates federal jurisdiction is the expansive language of Section 27 that follows the term "exclusive."

3. Although *Pan American* states in passing in a footnote that the NGA's exclusive-jurisdiction provision is limited to cases "arising under" the NGA, 366 U.S. at 665 n.2, the Court based that dictum not on the provision's text, but on its legislative history. Specifically, the NGA's legislative history stated that the exclusive-jurisdiction provision there governs "cases arising under the act." S. Rep. No. 1162, 75th Cong., 1st Sess. 7 (1937); see H. Rep. No. 709, 75th Cong., 1st Sess. 9 (1937) (same).

The NGA's legislative history is not a basis to ignore the Exchange Act's plain text, but in any event the legislative history here is quite different. Congress debated whether Section 27 should give federal courts exclusive or concurrent jurisdiction, but Congress understood that Section 27 would "give to the Federal district courts * * * jurisdiction." Senate Consideration and Amendment of S. 3420—H.R. 9323 as Amended Passed in Lieu, 78 Cong. Rec. 8563-8604, 8571 (May 11, 1934) (debating whether "it was the intention of the committee to give to the Federal dis-

trict courts exclusive jurisdiction of violations under the act" or "to give jurisdiction either to the Federal court or to the State courts of general jurisdiction"). Congress thus knew that it was conferring jurisdiction, and there is no evidence in the legislative record that Congress intended its grant of jurisdiction to be coterminous with general federal-question jurisdiction under Section 1331. Section 27's grant of jurisdiction therefore should be taken on its own terms, which clearly cover this case.

II. THE DECISION BELOW IS INCONSISTENT WITH THE PURPOSES OF SECTION 27.

A. Section 27 Ensures Uniform Federal Interpretation Of Exchange Act Liabilities And Duties.

The purpose of Section 27 is "to achieve greater uniformity of construction and more effective and expert application of" the Exchange Act and its implementing regulations. *Matsushita Elec. Indus. Co., Ltd.* v. *Epstein*, 516 U.S. 367, 383 (1996). The decision below unquestionably undermines that purpose by allowing plaintiffs to plead around Section 27 in state court and thus posing the very real "danger that state court judges who are not fully expert in federal securities law will say definitively what the Exchange Act means and enforce legal liabilities and duties thereunder." *Ibid.*; see Barry Friedman, *Under the Law of Federal Jurisdiction: Allocating Cases Between Federal and State Courts*, 104 Colum. L. Rev. 1211, 1241 (2004) (noting that state court adjudication of federal law tends to create disuniformity).

Indeed, the very point of Section 27's grant of exclusive federal jurisdiction is to ensure that "binding legal determinations of rights and liabilities under the

Exchange Act are for *federal courts only*." *Matsushita*, 516 U.S. at 384 (emphasis added). By creating exclusive federal jurisdiction, Congress furthered its interest in a "nationally uniform interpretation." *Reed* v. *Farley*, 512 U.S. 339, 348-349 (1994); see *Gulf Offshore Co.* v. *Mobil Oil Corp.*, 453 U.S. 473, 483-484 (1981) (observing that "desirability of uniform interpretation" is an interest advanced by grant of exclusive federal jurisdiction); see also *Grable & Sons Metal Prods., Inc.* v. *Darue Eng'g & Mfg.*, 545 U.S. 308, 312 (2005) (acknowledging "the experience, solicitude, and hope of uniformity that a federal forum offers on federal issues").

Uniform interpretation and application of the Exchange Act are essential to effectuating Congress's intent to "perfect the mechanisms of a *national market system* for securities and a *national system* for the clearance and settlement of securities transactions." 15 U.S.C. 78b (emphasis added). Unlike the Securities Act of 1933, a narrower statute that focuses on disclosure and fraud in connection with offerings of securities and that permits state courts to exercise concurrent jurisdiction over certain individual (*i.e.*, non-class) claims, see 15 U.S.C. 77v; *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 752 (1975), the Exchange Act is concerned with the operation of the national market for securities. Allowing state courts to establish competing interpretations of the Exchange Act and its regulations, thus subjecting market participants to different (and potentially conflicting) rules in the various States, is squarely at odds with Congress's manifest desire to facilitate a truly national securities market.

B. Uniform Federal Interpretation Of Exchange Act Liabilities And Duties Furthers Market Predictability And Efficiency.

1. Uniformity in the interpretation of the Exchange Act and its implementing regulations fosters a number of important federal policies and interests, including the need for predictability in the financial markets. See *Pinter* v. *Dahl*, 486 U.S. 622, 652 (1988) (noting that securities laws are "an area that demands certainty and predictability"). If the decision below were allowed to stand, market participants would face uncertainty not only with respect to *where* they may be compelled to defend against securities claims, but also with respect to *what* their duties and responsibilities will be under the federal securities laws. The practical reality is that market participants would be forced to comply with interpretations of the Exchange Act issued by numerous state courts under a patchwork of many States' laws—making it more difficult to ascertain what conduct does and does not run afoul of federal securities laws. That would defeat Section 27's purpose of achieving consistency in the rules governing trade settlement and clearing of securities transactions on national exchanges.

2. The uncertainty would be particularly pronounced with respect to short sales, which are very common transactions in which many market participants engage. Short selling involves "a sale of a security that the seller does not own or that is consummated by the delivery of a security borrowed by or on behalf of the seller." "Naked" Short Selling Antifraud Rule, SEC Release No. 34-58774, 73 Fed. Reg. 61,666, 61,667 (Oct. 17, 2008). So-called "naked" short selling occurs when "the seller does not borrow or arrange to borrow the securities in time to make delivery to the

buyer within the standard three-day settlement period." U.S. Securities and Exchange Commission, Office of Investor Education and Advocacy, *Key Points About Regulation SHO* (Apr. 8, 2015). To address concerns associated with abusive naked short selling, the Commission promulgated Regulation SHO, which places certain restrictions on short selling. See Christopher M. Salter & Christopher F. Chase, *Short Selling and Naked Shorts in the Regulation SHO Environment*, 40 Rev. Sec. & Commodities Reg. 232-33 (2007).

Those restrictions affect a wide variety of market participants, including those that engage in short selling as well as their brokers. See, *e.g.*, U.K. Financial Services Authority, *Discussion Paper no. 09/1—Short Selling* 7-9 (2009) (observing that short selling is a trading strategy frequently used by market makers and investment banks, as well as "traditional fund managers such as pension funds and insurance companies"). Indeed, for some market participants, short selling constitutes a significant portion or even the entirety of their trading strategy. See, *e.g.*, Ciara Connolly & Mark C. Hutchinson, *Dedicated Short Bias Hedge Funds: Diversification and Alpha during Financial Crises*, 3 (July 1, 2011), http://ssrn.com/abstract=1611627.

The SEC has observed that short selling provides "important benefits" to the market, including "market liquidity and pricing efficiency." Short Sales, SEC Release No. 34-48709, 68 Fed. Reg. 62,972, 62,974 (Nov. 6, 2003); see Amendments to Regulation SHO, SEC Release No. 34-59748, 74 Fed. Reg. 18,042, 18,044 (Apr. 20, 2009); International Organization of Securities Commissions, *Regulation of Short Selling—Consultation Report* 5 (2009). Short sellers "in-

crease liquidity, facilitate market making, and help markets to identify corporate fraud." Kevin A. Crisp, *Giving Investors Short Shrift: How Short Sale Constraints Decrease Market Efficiency and A Modest Proposal for Letting More Shorts Go Naked*, 8 J. Bus. & Sec. L. 135, 156 (2008).

According to the SEC, those benefits flow through to investors. By increasing liquidity, short selling enables "market professionals * * * [to] offset temporary imbalances in the buying and selling interest for securities." Amendments to Regulation SHO, 74 Fed. Reg. at 18,044. This "reduc[es] the risk that the price paid by investors is artificially high because of a temporary imbalance between buying and selling interest." *Ibid.* Short selling provides similar benefits to investors through increased pricing efficiency, which helps to ensure that investors relying on market pricing are not paying inflated prices for securities. See Ekkehart Boehmer & Julie Wu, *Short Selling and the Informational Efficiency of Prices*, 33-34 (Jan. 8, 2009) ("[P]rices appear to be closer to efficient or fundamental values when short sellers are more active."), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=972620.

3. Since 2006, short sellers, clearing brokers, and courts have seen an uptick in suits alleging violations of Regulation SHO. See Christopher L. Culp & J.B. Heaton, *The Economics of Naked Short Selling*, Regulation 47 (Spring 2008) ("Naked short selling has been the focus of an increasing number of lawsuits."). In light of the well-documented role that short selling plays in the market, the decision below stands to have a significant effect on financial markets. As claims concerning Regulation SHO increasingly are filed in state courts, there will be a corresponding increase in

"legal uncertainty for firms about whether activity that is lawful under the federal regulatory scheme may nevertheless be questioned in state court," which in turn "may cause firms to impose restrictions on customer short sale activity and limit proprietary short sale activity," thereby "reduc[ing] liquidity" and "harm[ing] the markets by making price discovery less efficient." Salter & Chase, *supra*, at 237.

That uncertainty would threaten the efficient settlement and clearing of securities transactions. Clearing firms—for mere fractions of a penny per share—perform the vital but ministerial "back office" functions necessary to clear and settle trades. Those firms settle millions of transactions every day. By subjecting them to litigation in myriad state courts applying varying interpretations of the Exchange Act and its accompanying regulations, the decision below threatens to disrupt their operations by raising costs or even driving firms to cease clearing operations. The negative consequences of disrupting the securities clearing system should not be underestimated: "The system routinely processes the multi-billion share trading volumes that characterize current securities markets. Without this highly efficient clearance and settlement system, modern securities markets simply could not function." Henry F. Minnerop, *Clearing Arrangements*, 58 Bus. Law. 917, 958 (2003).

C. Uniform Federal Interpretation Of Exchange Act Liabilities And Duties Prevents Forum Shopping.

1. Allowing state courts to implement varying interpretations of federal standards also would encourage litigants to engage in forum shopping. Plaintiffs will bring their actions for enforcement of *federal*

rules and regulations in *state* court by dressing up federal violations in the language of state law. Plaintiffs thus would be able to invoke federal substantive standards while simultaneously staving off federal jurisdiction. That result is precisely what an *exclusive*-jurisdiction provision like Section 27 is meant to avoid. See, *e.g.*, *Heller, Ehrman, White & MacAuliffe* v. *Babbitt*, 992 F.2d 360, 363 (D.C. Cir. 1993) (Plaintiffs "may not, by creatively framing their complaint, circumvent a congressional grant of exclusive jurisdiction.").

2. Litigants already have begun shifting their cases to state courts in search of greener pastures. Because of a lack of success on short selling claims brought in federal courts under the securities laws, "the plaintiffs' bar has turned its attention to state court claims" for naked short selling. Alexis Brown Stokes, *In Pursuit of the Naked Short*, 5 N.Y.U. J. L. & Bus. 1, 39 (2009); see, *e.g.*, *Overstock.Com, Inc.* v. *Goldman Sachs & Co.*, 231 Cal. App. 4th 513 (2014) (addressing, *inter alia*, whether trades were "designed to evade Regulation SHO"); *Life Partners Holdings Inc. et al.* v. *optionsXpress Inc. et al.*, No. 14CH6428 (Cir. Ct., Cook County, Ill. Apr. 14, 2014) (complaint repeatedly refers to Regulation SHO and alleges that defendants violated rules and regulations "designed to detect, monitor, and prevent the creation and sale of counterfeit-phantom stock").

Those attempts to plead state-law claims in state courts are undoubtedly driven by a desire not only to find a more hospitable forum for bringing short selling claims and to avoid more demanding federal pleading standards, but also to obtain remedies—like treble damages and attorney's fees—that are not generally available under the Exchange Act. See *Sedima*

S.P.R.L. v. *Imrex Co.*, 473 U.S. 479, 504-505 (1985) (Marshall, J., dissenting) ("[T]he federal securities laws contemplate only compensatory damages and ordinarily do not authorize recovery of attorney's fees. By invoking RICO, in contrast, a successful plaintiff will recover both treble damages and attorney's fees."); see also, *e.g.*, N.J. Stat. Ann. 2C:41-4(a)(8) (RICO statute authorizing treble damages); Ariz. Rev. Stat. 13-2314.04(A) (same).

Those efforts will only multiply as the number of suits alleging Regulation SHO violations increases. As state courts develop varying interpretations of the duties imposed by Regulation SHO, litigants will seek out the most favorable forum. In light of the "need for uniform enforcement" of the Exchange Act, *California* v. *Am. Stores Co.*, 492 U.S. 1301, 1306 (1989), this Court should put an end to forum shopping over short selling claims, provide clarity and predictability to a substantial segment of the securities markets, and hold that Section 27 confers original federal jurisdiction over claims predicated on violations of the Exchange Act or regulations promulgated thereunder (such as Regulation SHO).

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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SEPTEMBER 10, 2015

SUPREME COURT, U.S.
FILED
SEP 10 2015
OFFICE OF THE CLERK

No. 14-1132

IN THE

Supreme Court of the United States

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., ET AL.,

Petitioners,

v.

GREG MANNING, ET AL.,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

BRIEF OF NASDAQ, INC., NASDAQ STOCK MARKET LLC, NEW YORK STOCK EXCHANGE LLC, NYSE ARCA, INC., AND NYSE MKT LLC, *AS AMICI CURIAE* IN SUPPORT OF PETITIONERS

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BRIEF OF NASDAQ, INC., NASDAQ STOCK MARKET LLC, NEW YORK STOCK EXCHANGE LLC, NYSE ARCA, INC., AND NYSE MKT LLC, AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

INTEREST OF *AMICI CURIAE*

NASDAQ, Inc. and NASDAQ Stock Market LLC (collectively, "NASDAQ") and New York Stock Exchange LLC, NYSE Arca, Inc., and NYSE MKT LLC (collectively, "NYSE") operate the principal stock exchanges in the United States.[1] *Amici*'s exchanges are the global leaders in raising capital for listed companies and have provided a reliable, orderly, and efficient marketplace for securities trading for many decades. As entities directly and comprehensively governed by the Securities Exchange Act of 1934 ("Exchange Act") and the U.S. Securities and Exchange Commission ("SEC"), NASDAQ and NYSE have a keen interest in the Exchange Act's effective and uniform application and interpretation.

NASDAQ and NYSE are registered with the SEC as national securities exchanges under the Exchange Act and are self-regulatory organizations ("SROs") within the meaning of 15 U.S.C. § 78c(a)(26). The Exchange Act both authorizes and requires SROs to adopt and enforce rules governing the conduct of

[1] All parties have consented to the filing of this brief. The written consents have been lodged with the Clerk of the Court. Pursuant to Supreme Court Rule 37.6, *amici* state that no counsel for a party authored this brief in whole or in part; and that no person or entity, other than *amici* and their counsel, made a monetary contribution intended to fund the preparation and submission of this brief.

their members and persons associated with their members, *id.* §§ 78f(b), 78s(g), "to remove impediments to and perfect the mechanism of a free and open market," and "to protect investors and the public interest," *id.* § 78f(b)(5). More generally, the Exchange Act authorizes and requires SROs to adopt and enforce rules governing the operations of their markets. *See ibid.*

Amici have a substantial interest in the uniform application of federal securities law, as envisioned by the Exchange Act. Organized and consistent regulation of SROs under the Exchange Act provides SROs with a coherent, predictable framework so that they can fulfill their regulatory duties as Congress intended, without fear of recriminatory and unpredictable lawsuits in various state courts.

Amici believe that the Exchange Act's grant of exclusive federal jurisdiction for suits involving the Exchange Act or any rules promulgated thereunder—including the SRO rules discussed above—is necessary to promote and maintain the uniform regulatory framework created by Congress. Without exclusive federal jurisdiction, SROs would be exposed to regulation by state courts across the country. If the Third Circuit's view in this case were to prevail, *amici* anticipate a substantial degradation of the consistency, reliability, and predictability of the legal regime that governs SROs, provides consistent application of SRO rules to members and their associated persons, and contributes to the investing public's confidence in the markets. Exposing SROs to litigation under each separate state system is a serious threat to the uniformity that Congress envisioned. The resulting patchwork of regulatory schemes would make it extremely difficult and costly for

SROs like *amici* to perform their congressionally mandated functions, and in turn would undermine the nation's securities markets.

The consequences of the Court's ruling in this case, in other words, will be visited most directly and pervasively on SROs, which are the most frequent litigants in cases involving Section 27. *Amici* therefore possess highly relevant experience regarding how litigation in cases implicating Section 27 affects SROs' effective functioning under the Exchange Act's regulatory system.

STATUTORY PROVISION INVOLVED

Section 27 of the Securities Exchange Act, 15 U.S.C. § 78aa(a), provides in relevant part:

> The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder.

SUMMARY OF ARGUMENT

I. Section 27 of the Exchange Act provides that federal district courts "shall have exclusive jurisdiction" over any lawsuits alleging "violations" of the Act or its regulations, or seeking to "enforce any liability or duty" they create. The provision is an affirmative grant of exclusive jurisdiction, not simply a divestiture of concurrent jurisdiction in the state courts, and its application does not turn on whether

the plaintiff characterizes its claim as arising under state or federal law.

The Third Circuit concluded that Section 27 is not an independent grant of jurisdiction, and that claims falling within its terms may proceed in federal court only if some other basis for jurisdiction applies. But the plain language of the statute—"*shall have* exclusive *jurisdiction*"—confers jurisdiction on the federal courts. That jurisdiction under Section 27 is *also* exclusive does not change this conclusion. Moreover, it is irrelevant whether the plaintiff chooses to characterize its lawsuit as arising under state law. This conclusion is aptly illustrated in cases against SROs, which constitute the overwhelming majority of lawsuits in which Section 27 is litigated. The majority of the decisions to consider the issue have correctly concluded that the purportedly state-law nature of the claims asserted is immaterial provided that they allege "violations" of, or seek to "enforce any liability or duty" created by, the Exchange Act, SEC rules, or SRO rules. *See, e.g.*, *Hawkins* v. *NASD*, 149 F.3d 330 (5th Cir. 1998); *Sparta Surgical Corp.* v. *NASD*, 159 F.3d 1209 (9th Cir. 1998).

II. Section 27 reflects Congress's desire to promote uniformity and predictability in the securities markets by ensuring that the content and application of the Exchange Act and the rules thereunder are determined by federal courts. This goal is particularly important in the SRO context, where permitting state-court litigation against SROs based on alleged violations of the Exchange Act, SEC rules, or SRO rules—or the duties and rights created thereunder—would subject national exchanges to numerous additional regulators and lead to inconsistent interpretations of federal law across the country.

A. The Exchange Act's comprehensive system of federal regulation relies on self-regulation by SROs. SROs promulgate rules governing their members, which are subject to SEC approval, abrogation, or alteration. SROs also conduct investigations and examinations, which are also subject to comprehensive review by the SEC, and are designed to identify and prevent rule violations by their members.

B. Section 27 funnels challenges to SRO actions into the federal court system to ensure that those actions are judged by a uniform federal standard, as applied by the federal courts and the SEC. This uniformity is important because SROs must make innumerable regulatory decisions that potentially affect market participants, and they can do so only with the certainty that their actions will be judged by a consistent federal standard that is consistently applied. In contrast, if state courts were permitted to adjudicate state-law claims resting on the premise that an SRO violated the Exchange Act, SEC rules, or the SRO's own rules, then each state could adopt differing interpretations of those provisions that would effectively impose different requirements from other states and from the uniform federal standard.

II. The Third Circuit reached a contrary conclusion based largely on Second Circuit *dicta* in a decision predating the contrary authority from other courts of appeals. That decision—*Barbara* v. *NYSE*, 99 F.3d 49 (2d Cir. 1996)—did not discuss or analyze the text of Section 27. Rather, it treated that provision as largely coextensive with federal-question jurisdiction (and thus inapplicable to many state-law claims) before upholding jurisdiction on other grounds. In addition to being incorrectly reasoned, *Barbara*'s jurisdictional *dicta* has been undermined

by subsequent Second Circuit decisions, which have upheld jurisdiction under Section 27 on materially indistinguishable facts and, notably, invoked that provision in support of jurisdiction over state-law claims.

ARGUMENT

Section 27 of the Exchange Act provides that "[t]he district courts of the United States . . . shall have exclusive jurisdiction of violations of [the Exchange Act] or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by [the Exchange Act] or the rules and regulations thereunder." 15 U.S.C. § 78aa(a). As Petitioners have explained, this provision is an affirmative grant of exclusive federal jurisdiction to the federal courts, and the Third Circuit erred in concluding otherwise. *See* Pet. Br. 19–23, 28–31.

Amici submit this brief to emphasize the importance of Section 27 to the proper and uniform functioning of the securities markets. By granting exclusive federal jurisdiction over claims involving alleged "violations" of the Exchange Act or the regulations thereunder, or seeking to "enforce any liability or duty" that they create, Congress channeled all litigation in this area—including lawsuits against SROs based on their SEC-approved rules—into the federal system. Any contrary rule would expose SROs to potentially conflicting interpretations of the Exchange Act, the SEC's rules, and SRO rules, and would subject SROs to regulation by the fifty states—rather than a single and uniform system of federal regulation.

Most cases addressing Section 27 have involved SROs, and the majority of these decisions have cor-

rectly concluded that the statute's grant of exclusive federal jurisdiction cannot be dismissed as merely depriving state courts of concurrent jurisdiction. The outlier before this case—a Second Circuit decision relied upon below—was wrongly decided and has been thoroughly undermined even within the Second Circuit itself; it should therefore provide no support for adopting an interpretation of Section 27 that would destroy its critical role in ensuring the uniform federal interpretation of the Exchange Act, including the regulatory system governing SROs.

I. SECTION 27 OF THE EXCHANGE ACT IS A BROAD GRANT OF EXCLUSIVE FEDERAL JURISDICTION.

Section 27 provides that "[t]he district courts of the United States . . . *shall have* exclusive *jurisdiction of violations* of [the Exchange Act] or the rules and regulations thereunder, *and of all suits in equity and actions at law brought to enforce any liability or duty* created by [the Exchange Act] or the rules and regulations thereunder." 15 U.S.C. § 78aa(a) (emphases added). Whenever a lawsuit alleges "violations" of the Exchange Act or its regulations, or seeks to "enforce any liability or duty" created by the Exchange Act or its regulations—no matter how a plaintiff might characterize its claim—federal jurisdiction attaches and is exclusive. Neither prong of Section 27 turns on whether the Exchange Act itself creates the *claim* that is being asserted, and thus it is irrelevant whether the asserted claims purport to arise under state law. Indeed, the source of the asserted cause of action is irrelevant to Section 27's grant of federal jurisdiction.

A. The Third Circuit acknowledged below that all of Respondents' claims sought to establish a viola-

tion of, or enforce a duty created by, Regulation SHO, which imposes certain requirements on broker-dealers before they process short-sell orders. *See* App. 8a–9a; *see also id.* at 29a (same conclusion by district court). In fact, as the court noted, Respondents "repeatedly" alleged that Petitioners "violated" Regulation SHO. *Id.* at 8a–9a.[2] The Third Circuit nonetheless concluded that Section 27 "does not provide an independent basis to exercise [federal] jurisdiction," but instead merely "divest[s] state courts of jurisdiction" over claims within its scope. App. 22a. Thus, on the Third Circuit's view, the federal courts would have jurisdiction in this case only if there were some *other* basis—such as federal question—for exercising jurisdiction. *Ibid.*

The Third Circuit's decision cannot be reconciled with the text of Section 27, which expressly grants jurisdiction to federal courts rather than merely divesting jurisdiction from state courts: Section 27 unambiguously states that the federal courts "*shall have* exclusive *jurisdiction*" over the types of lawsuits covered by its terms. 15 U.S.C. § 78aa(a) (emphases added). This grant of authority is not negated merely because it is also exclusive. *See* Pet. Br. 29.

This textual reading is further strengthened by comparing Section 27 to Section 22 of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. § 77v. Both as originally enacted and as revised, Section 22 provides—just as Section 27 does with respect to the Exchange Act—that federal district courts "shall have

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[2] *Amici* take no position on the merits of the claims asserted or practices alleged below. *Amici* are solely interested in addressing issues raised by the Third Circuit's misinterpretation of Section 27.

jurisdiction" over claims alleging "violations" of the Securities Act or seeking to "enforce any liability or duty" that the Act creates. *See id.* § 77v(a); *see also* Securities Act of 1933, Pub. L. No. 73-22, § 22, 48 Stat. 74, 86.

This identical language is striking, but equally striking is the key difference: The word "exclusive" appears in Section 27 but not in Section 22. This should resolve the textual question in favor of Petitioners. As they correctly note, Section 22 is an affirmative grant of federal jurisdiction independent of federal-question jurisdiction under 28 U.S.C. § 1331. *See* Pet. Br. 30. Section 27 was adopted only one year later, by the same Congress. With jurisdictional language that differs only in its emphatic insistence on federal exclusivity, Section 27 cannot reasonably be interpreted to provide a *narrower*—indeed, on the Third Circuit's view, non-existent—grant of jurisdiction than Section 22. Moreover, the distinction between the two provisions with respect to exclusivity was not accidental; although Securities Act cases in many instances present no particular problems when litigated in state courts, the Exchange Act is predicated on the need for precision and national uniformity, thus making the need for exclusive federal jurisdiction imperative. *See infra* Part II.

B. The only inquiry necessary to determine whether a federal court has jurisdiction under Section 27 is whether the asserted claims (i) allege "violations of [the Exchange Act] or the rules and regulations thereunder," or (ii) seek to "enforce any liability or duty created by [the Exchange Act] or the rules and regulations thereunder." 15 U.S.C. § 78aa(a). Neither inquiry depends on what a plaintiff happens to *call* its claims, and neither depends on the label

(state or federal) attached to the relevant cause of action. Instead, Section 27 looks to what conduct the claims at issue challenge.

This point is illustrated most forcefully in lawsuits against SROs, which almost invariably implicate SROs' regulatory duties under the Exchange Act, the SEC's rules, or the SROs' own rules, and thus are subject to exclusive federal jurisdiction under Section 27.

Indeed, a reported Section 27 decision that does *not* involve an SRO is rare, as the bulk of the Section 27 cases cited in the certiorari-stage briefing in this Court illustrated. *See, e.g.*, Pet. 14–17; Opp. 23–26. In the context of such cases, the federal courts have repeatedly invoked Section 27 as a basis for federal jurisdiction—typically before dismissing the lawsuit at issue as barred by SROs' absolute immunity from claims challenging the exercise of their regulatory functions or by other federal doctrines (*e.g.*, the exclusivity of the Exchange Act's process for reviewing SRO actions). *See, e.g.*, *Sparta Surgical Corp.* v. *NASD*, 159 F.3d 1209, 1211–12 (9th Cir. 1998) (affirming denial of remand prior to dismissal); *Hawkins* v. *NASD*, 149 F.3d 330, 331–32 (5th Cir. 1998) (same); *see also, e.g.*, *In re NYSE Specialists Sec. Litig.*, 503 F.3d 89, 98 (2d Cir. 2007) (Sotomayor, J.) (noting that SROs are immune where the "specific acts and forbearances" at issue "were incident to the exercise of regulatory power").[3] The Third Circuit

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[3] Decisions from the district courts are in accord. *See, e.g.*, *Lowe* v. *NASD Regulation*, No. 99-1751, 1999 WL 1680653, at *2–*4 (D.D.C. Dec. 14, 1999) (denying motion to remand); *Hibbard Brown & Co.* v. *NASD*, No. 94-285, 1994 WL 827778, at *2 (D. Del. Oct. 6, 1994) (same).

could not square its judgment with these cases, ultimately conceding that it simply "disagree[d]" with *Sparta* and *Hawkins*. *See* App. 20a & n.9.

In *Sparta*, a plaintiff brought purported state-law claims alleging that an SRO—the National Association of Securities Dealers ("NASD")—violated its own rules by suspending trading in two public offerings and delisting the shares. NASD's rules are promulgated under the Exchange Act, *see* 15 U.S.C. § 78s(b), and thus are "rules . . . thereunder" for purposes of Section 27. Because the lawsuit "sought relief based upon [alleged] violation of exchange rules," the Ninth Circuit held that "subject-matter jurisdiction was specifically vested in the federal district court under the Exchange Act." 159 F.3d at 1211.

Significantly, the Ninth Circuit noted that (as in this case) the claims at issue were "posited as state law claims." 159 F.3d at 1212. But they were nonetheless "founded on [NASD's] conduct in suspending trading and de-listing the offering, the propriety of which must be exclusively determined by federal law"—that is, the NASD's rules and the Exchange Act's detailed grant of authority to SROs—and thus "any claim falls under the imperative" of Section 27. 159 F.3d at 1212; *see also ibid.* ("The viability of any cause of action founded upon NASD's conduct in delisting a stock or suspending trading depends on whether the association's rules were violated.").

Similarly, in *Hawkins*, the plaintiff brought a state-law claim alleging that NASD violated "duties [that] arise from the NASD Code of Arbitration Procedure, which is a body of rules approved by the [SEC]." 149 F.3d at 331–32. The Fifth Circuit construed the plaintiff's attempt to enforce SRO rules as an "actio[n] at law seeking to enforce liabilities or

duties created by federal securities laws which are governed exclusively by federal courts." *Id.* at 332. Although the plaintiff's claims were "carefully articulated in terms of state law," the Fifth Circuit held that they fell within the exclusive jurisdiction of the federal courts because, *in substance*, they sought to "enforce liabilities or duties created by federal securities laws." *Ibid.*

* * *

Sparta and *Hawkins* illustrate two critical points that the Third Circuit missed. *First*, Section 27 is an affirmative grant of jurisdiction to the federal courts that is effective (and exclusive) regardless of whether federal jurisdiction might or might not exist under some other statute. *Second*, to determine whether Section 27 applies, the issue is not whether the cause of action sounds in federal law, but instead whether the claims allege "violations" of the Exchange Act or its regulations, or "seek to enforce rights or duties" that they create. This Court should endorse both propositions, and the Fifth and Ninth Circuit's analyses in *Sparta* and *Hawkins*, which together are sufficient to reverse the judgment below.

II. EXCLUSIVE FEDERAL JURISDICTION IS NECESSARY FOR EFFICIENT FUNCTIONING AND EFFECTIVE REGULATION OF THE NATION'S SECURITIES MARKETS.

As with other comprehensive federal regulatory systems,[4] this Court has recognized that the Ex-

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[4] *See, e.g., United States* v. *Locke*, 529 U.S. 89, 97 (2000) (maritime vessels); *Bonito Boats, Inc.* v. *Thunder Craft Boats, Inc.*, 489 U.S. 141, 162–63 (1989) (patent law); *Rogers' Estate* v. *Helvering*, 320 U.S. 410, 414 (1943) (federal taxation).

change Act—and Section 27 in particular—are intended "to achieve greater uniformity of construction and more effective and expert application of that law." *Matsushita Elec. Indus. Co.* v. *Epstein*, 516 U.S. 367, 382 (1996). These objectives would be difficult, if not impossible, to achieve without the exclusive federal jurisdiction that Section 27 creates.

A. SROs Play A Key Role In Securities Trading And Regulation.

The Exchange Act creates "a detailed, comprehensive system of federal regulation of the securities industry" founded on "self-regulation by industry organizations." *Swirsky* v. *NASD*, 124 F.3d 59, 61 (1st Cir. 1997). This "regulatory model" depends, in part, on the "delegation of certain government functions to private SROs," *In re Series 7 Broker Qualification Exam Scoring Litig.*, 548 F.3d 110, 114 (D.C. Cir. 2008), which "serv[e] as a critical aid to the SEC in implementing and effectuating compliance with the securities laws," *DL Capital Group* v. *NASDAQ Stock Market*, 409 F.3d 93, 95 (2d Cir. 2005).

1. SROs are private, non-governmental organizations that have the power to create and enforce industry regulations and standards. They have long played an important role in securities markets and securities regulation. In 1792, the New York broker community formed the first organized stock market (*viz.*, NYSE). *See Concept Release Concerning Self-Regulation* ("*Concept Release*"), SEC Release No. 34-50700, 69 Fed. Reg. 71,256, 71,257 (Dec. 8, 2004). As NYSE and other stock exchanges developed, trading conventions became formalized as exchange rules. *Ibid.*

Federal regulation of SROs began in 1934 with the Exchange Act, which required exchanges to reg-

ister with the SEC and to function as SROs. *See Concept Release*, 69 Fed. Reg. at 71,257. In 1938, the Maloney Act amended the Exchange Act to allow the formation of non-exchange SROs, which led to the creation of NASD (now known as the Financial Industry Regulatory Authority) and the National Futures Association. *See ibid.*

As securities trading developed, and in an attempt to increase the fairness, competitiveness, and efficiency of U.S. securities markets, Congress passed the Exchange Act Amendments of 1975. *See* SEC, Division of Market Regulation, *Market 2000: An Examination of Current Equity Market Developments* ("*Market 2000*") at I-3–I-5 (Jan. 1994), *at* https://www.sec.gov/divisions/marketreg/market2000.pdf. The 1975 Amendments provided a new framework for a national market system and, while reiterating Congress's commitment to self-regulation, granted the SEC significantly broader oversight power over SROs. *See Market 2000* at I-4–I-5.

As the SEC has observed, the Exchange Act, the Maloney Act, and the 1975 Amendments "reflect Congress' determination to rely on [SROs] as a fundamental component of U.S. market and broker-dealer regulation" for at least three reasons. *Concept Release*, 69 Fed. Reg. at 71,256. *First*, it was far more cost-effective for SROs to "effectively regulat[e] the inner-workings of the securities industry." *Ibid. Second*, "the complexity of securities trading practices made it desirable for SRO regulatory staff to be intimately involved with SRO rulemaking and enforcement." *Ibid. Third*, "the SROs could set standards that exceeded those imposed by the Commission, such as just and equitable principles of trade

and detailed proscriptive business conduct standards." *Ibid.* Congress thus determined that, without SROs and their important function in providing standardized and predictable governance, fair and efficient securities regulation would not be possible.

2. SROs are responsible for promulgating and enforcing rules that govern all aspects of their members' securities business, including their financial condition, operational capabilities, sales practices, and qualifications of their personnel. *See, e.g.*, 15 U.S.C. §§ 78f(b), 78*o*-3(b), 78s(b). With few exceptions, the SEC must approve all SRO rules, policies, practices, and interpretations before they are implemented. *See id.* § 78s(b). And because SRO rules are approved by the SEC, those rules share the preemptive effect of other federal regulations. *See Credit Suisse First Boston Corp.* v. *Grunwald*, 400 F.3d 1119, 1128 (9th Cir. 2005). The SEC is also empowered to "abrogate, add to, and delete from" SRO rules "as the Commission deems necessary or appropriate." 15 U.S.C. § 78s(c); *see generally, e.g.*, *Shearson/Am. Express Inc.* v. *McMahon*, 482 U.S. 220, 233–34 (1987) (describing the SEC's authority to approve, disapprove, or modify SRO rules).

In fulfilling their regulatory functions, SROs also conduct investigations and examinations at their members' premises, monitor financial and other operational reports, investigate potential rule violations, and bring disciplinary proceedings when appropriate. *See Concept Release*, 69 Fed. Reg. at 71,261. In addition, SROs monitor trading on the markets they operate to detect evidence of rule violations and other improper practices, such as insider trading and market manipulation. *Ibid.*

With respect to each of these SRO activities, the SEC's review authority is comprehensive. The SEC is authorized to review actions taken by SROs "on its own motion, or upon application by any person aggrieved thereby." 15 U.S.C. § 78s(d)(2). In this way, and through its power over the creation and modification of SRO rules, the SEC provides significant—and uniform—oversight of SROs. The goal of this process, as Congress intended, is fair treatment of investors and fair competition among markets and market participants. *See id.* § 78f(b)(5).

B. Exclusive Federal Jurisdiction Provides Uniformity That Is Necessary For SROs To Function Effectively.

The absence of an SRO as a party makes this an unusual reported Section 27 decision. Given their centrality to securities regulation and their prominent role within the Exchange Act in particular, SROs are almost universally among the parties to suits generating reported decisions on Section 27. Indeed, the three other cases that comprise the circuit split invoked by Petitioners in this case all involved lawsuits against SROs. *Compare Barbara* v. *NYSE*, 99 F.3d 49 (2d Cir. 1996), *with Hawkins*, 149 F.3d 330, *and Sparta*, 159 F.3d 1209. It is precisely that context that illustrates most clearly the importance of uniform administration and interpretation of the Exchange Act, the SEC's rules, and SRO rules, which Section 27 provides as properly construed.

1. Uniformity is critical because SROs must be nimble, which is possible only if they can make regulatory decisions and respond to changing market conditions without fear that their actions will be

judged under varying and unpredictable standards in different states. *See, e.g.*, *DL Capital*, 409 F.3d at 99 (cautioning against "disruptive and recriminatory lawsuits" that would "unduly hampe[r]" SROs' "quasi-governmental functions"). Indeed, Congress included SROs as part of the Exchange Act's regulatory regime because of their unique ability to bring the "informality and flexibility of self-regulatory procedures" into complex, ever-changing securities markets. S. Doc. No. 93-13, at 149 (1973). SROs can fulfill that function only because the system of exclusive regulation by the SEC and federal courts provides them with clear and uniform guidance on the proper use and limits of their power.

This regulatory system has given rise to a robust body of federal case law that provides predictable means to resolve complaints against SROs. Federal courts have applied the doctrines of regulatory immunity and exclusive federal review to safeguard SROs' independent regulatory judgments from second-guessing by dissatisfied market participants. *See, e.g.*, *Series 7*, 548 F.3d at 115 ("Congress did not intend the regulatory duties at issue here to be enforced by common law causes of action."); *Sparta*, 159 F.3d at 1215 (rejecting a "theory [that] would allow states to define by common law the regulatory duties of a self-regulatory organization").

Similarly, the federal courts' insistence that plaintiffs pursue administrative remedies before the SEC has reinforced the centralized, expert system of SRO regulation created by Congress. *See, e.g.*, *Series 7*, 548 F.3d at 114 (holding that "[t]he multiple layers of review" for SRO actions "evince Congress's intent to direct challenges . . . to the avenues Congress created"); *see also Altman* v. *SEC*, 687 F.3d 44, 46 (2d

Cir. 2012) (per curiam) (holding that the Exchange Act's review process "suppl[ies] the jurisdictional route that [litigants] must follow to challenge" actions subject to that process).

Fidelity to these doctrines in federal court has ensured that SROs maintain the discretion and flexibility required to regulate and operate the markets and that the Exchange Act's promise of uniform, expert regulation of the securities markets remains fulfilled. Indeed, the existence of a coherent body of federal law interpreting these doctrines, the Exchange Act, and the SEC's regulations provides SROs with the predictable framework that they need to undertake their critical function.

2. Discarding this uniformity in favor of a state-by-state approach to interpretation of the Exchange Act, SEC rules, and SRO rules would wreck this carefully calibrated system. SROs would, in effect, acquire scores of new regulators, with each state being able to offer its own interpretation of SROs' rules and duties. With so many jurisdictions putting their own glosses on the Exchange Act and the rules promulgated thereunder, conflicting judicial mandates become practically inevitable. The mere *possibility* of these results is enough to destroy the vital predictability and certainty that Congress sought to provide through access to the federal court system. *See, e.g.*, *Sparta*, 159 F.3d at 1215 (noting that state-by-state regulation of SROs "cannot co-exist with the Congressional scheme of delegated regulatory authority under the Exchange Act").

The patchwork regulatory system that would follow from the decision below would, therefore, threaten SROs' abilities to perform their core functions under the Exchange Act. Simply monitoring the devel-

opments across fifty or more jurisdictions would impose enormous new burdens on SROs; attempting to comply with all of the ever-changing and overlapping rulings would be virtually impossible. SROs would lose their unique ability to respond quickly and decisively to changing market conditions. And the Exchange Act's vision of a uniform, national system of securities-markets regulation would be destroyed.

3. This Court has already recognized the significance of these concerns. Explaining the reasons behind the preemptive effect of the securities laws, the Court highlighted the dangers of permitting varying interpretations in state courts across the country: "[P]laintiffs may bring lawsuits throughout the Nation in dozens of different courts with different nonexpert judges and different nonexpert juries. . . . [I]t will prove difficult for those many different courts to reach consistent results." *Credit Suisse Sec. (USA) LLC* v. *Billing*, 551 U.S. 264, 281 (2007).[5] The Court rejected the imposition of antitrust law into the collective-bargaining context for similar reasons, decrying the resulting "web of detailed rules spun by many different nonexpert antitrust judges and juries" that would replace the uniform "set of . . . rules enforced by a single expert administrative body." *Brown* v.

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[5] As Petitioners note, state courts have in rare instances purported to exercise jurisdiction over Section 27 cases. *See* Pet. Br. 25 n.8. Those cases provide no support for disregarding Section 27's express grant of "exclusive" federal jurisdiction, and in any event simply demonstrate why Congress found it essential to limit jurisdiction to the federal courts. *See* Pet. Br. 25 n.8; *see also, e.g.*, *Platinum Partners Value Arbitrage Fund, Ltd. P'ship* v. *Chi. Bd. Options Exch.*, 976 N.E.2d 415 (Ill. Ct. App. 2012) (state court decision at odds with federal jurisprudence involving SROs).

Pro Football, Inc., 518 U.S. 231, 242 (1996); *see also, e.g., United States* v. *NASD*, 422 U.S. 694, 729–30 (1975) (holding that "the antitrust laws must give way if the regulatory scheme established by the Investment Company Act is to work").

These concerns apply with greater force here. Indeed, given the technical subject matter and the heightened need for uniform regulation of SROs, Congress saw fit to exclude even federal district courts from the regulatory process in most instances. The Exchange Act channels complaints over SROs' decisions through the SEC to ensure expert interpretation of these technical statutes and regulations. *See* 15 U.S.C. § 78s(a)-(d), (g)-(h). From there, the Exchange Act funnels complaints about the SEC's decision not to a federal district court (or, as Respondents wish here, a state trial court), but to a federal court of appeals. *See id.* § 78y(a)(1); *see also, e.g., Series 7*, 548 F.3d at 114; *Altman*, 687 F.3d at 46. In a comprehensively crafted system that displaces trial court litigation in most circumstances, and channels litigation exclusively through the federal courts, the threat to uniformity that necessarily would flow from the Third Circuit's interpretation of Section 27 would be especially egregious. This Court should refuse to permit such a result.

* * *

For all of these reasons, Congress focused on the overriding need for centralized, uniform interpretation of the Exchange Act and its accompanying regulations when it enacted Section 27: "[T]he exclusive-federal-jurisdiction provision in the 1934 act was motivated by a desire to achieve a greater uniformity of construction . . . than would be possible if the many state courts were to be kept in line only through the

Supreme Court's certiorari jurisdiction." Louis Loss, *The SEC Proxy Rules and State Law*, 73 Harv. L. Rev. 1249, 1275 (1960). This Court should recognize the good sense of that approach and honor the statute's text, which (as discussed above) plainly codifies Congress's vision of uniform federal interpretation of the Exchange Act and the rules thereunder.

III. THE SECOND CIRCUIT'S MORE RECENT OPINIONS HAVE CALLED INTO QUESTION ITS ERRONEOUS DECISION IN *BARBARA* V. *NEW YORK STOCK EXCHANGE*.

Because the plain text and overriding objectives of Section 27 unambiguously demonstrate that the statute confers exclusive federal jurisdiction, all that remains of the Third Circuit's contrary analysis is its heavy reliance on the Second Circuit's decision in *Barbara*. But *Barbara* was incorrectly decided, predated *Sparta* and *Hawkins*, and in any event has subsequently been narrowed within the Second Circuit itself. The Third Circuit's reliance on *Barbara* for its Section 27 analysis only further demonstrates the infirmity of the judgment below.

A. The facts of *Barbara* were straightforward. The plaintiff worked as a "floor clerk" at different NYSE member firms, and thus was given access to NYSE's floor pursuant to NYSE's rules. 99 F.3d at 51–52. This changed, however, when the plaintiff was investigated by NYSE's enforcement arm and, during the course of the investigation, was barred from the exchange floor. *Ibid.* Although this disciplinary action was eventually reversed by NYSE's board of directors, the experience effectively ended the plaintiff's career. *Ibid.*

The jurisdictional issue arose when the plaintiff filed suit in New York state court, alleging various

state-law causes of action on the theory that NYSE "had wrongfully barred him from the Exchange floor, thereby damaging [his] reputation and causing him to lose employment opportunities." 99 F.3d at 52. NYSE removed the case to federal court, and the plaintiff did not challenge removal. *Ibid.* NYSE moved to dismiss the complaint, arguing (among other things) that the lawsuit was barred by SROs' absolute immunity for their regulatory actions. The plaintiff sought leave to file an amended complaint before NYSE had filed its responsive pleading; the proposed amended complaint added claims that NYSE denied him due process in violation of the Fifth Amendment to the United States Constitution and 42 U.S.C. § 1983. The district court granted NYSE's motion to dismiss and denied as moot the plaintiff's motion to amend. 99 F.3d at 53.

On appeal, the Second Circuit considered federal jurisdiction *sua sponte*, and stated that the district court lacked jurisdiction over the plaintiff's original complaint. 99 F.3d at 53-56. None of the jurisdictional issues—in particular, those at issue here—had been addressed in the parties' briefs.

First analyzing the original complaint under 28 U.S.C. § 1331, the court noted that each claim was asserted under state law and that any federal issues—including SRO immunity—were defenses and thus could not by themselves create federal jurisdiction, *see* 99 F.3d at 53.

The Second Circuit then considered whether jurisdiction was appropriate under the rule providing federal jurisdiction where "the plaintiff's right to relief under state law necessarily depends on resolution of a substantial question of federal law." 99 F.3d at 54 (citation and alteration omitted). As the court

acknowledged, the plaintiff's "state court complaint [did] make factual allegations that the [NYSE] violated . . . internal rules" that it had established pursuant to the Exchange Act and under the SEC's supervision. *Ibid.*

According to the Second Circuit, however, this federal nexus was insufficient to warrant federal jurisdiction for two reasons. *First*, the Exchange Act lacks a private right of action to enforce NYSE rules, which—despite detailed provisions in the Exchange Act governing review of those rules, *see* 15 U.S.C. §§ 78s(b) (SEC review), 78y(a)(1) (subsequent review by a court of appeals)—the Second Circuit (incorrectly) understood to mean that federal law could not have created the rule of decision for the plaintiff's claims. 99 F.3d at 54. *Second*, the Second Circuit believed that NYSE's rules were "contractual in nature . . . and are thus interpreted pursuant to ordinary principles of contract law, an area in which the federal courts have no special expertise." *Id.* at 54–55 (citation omitted).

Finally, the Second Circuit rejected Section 27 as an independent basis for jurisdiction. The court stated that its "determination that [the plaintiff's] state court complaint did not 'arise under' federal law within the meaning of section 1331 effectively resolve[d] [its] inquiry under section 27 of the Exchange Act as well." 99 F.3d at 55. According to the court, Section 27's text "plainly refers to claims created by the [Exchange] Act or by rules promulgated thereunder, but not to claims created by state law." *Id.* at 55. Thus, the court largely merged the inquiries under federal-question jurisdiction and Section 27, and did not meaningfully analyze or even discuss the terms of Section 27.

B. As an initial matter, *Barbara*'s discussion of jurisdiction over the plaintiff's *original* complaint was unnecessary and thus *dicta*. Following that discussion, the court addressed the import of the plaintiff's proposed *amended* complaint. That pleading plainly would have given the district court jurisdiction because the plaintiff sought to amend his complaint to add claims that were *expressly federal*, "thereby conferring subject matter jurisdiction upon the federal courts." 99 F.3d at 56. There was, accordingly, no need to reach out and decide a jurisdictional question that was self-evidently and immediately mooted by the amended complaint.

Having found jurisdiction through the amended complaint, the Second Circuit then affirmed the district court's judgment of dismissal because the disciplinary proceedings at issue were part of NYSE's "official duties" for which it had absolute immunity from suit. *Id.* at 58–59.

C. Moreover, the Second Circuit's subsequent case law has significantly narrowed *Barbara*'s jurisdictional *dicta* and cast grave doubt on its logic.

D'Alessio v. *NYSE*, 258 F.3d 93 (2d Cir. 2001), provided the Second Circuit's initial step back from *Barbara*'s *dicta*. In *D'Alessio*, the plaintiff—as in *Barbara*—had been suspended from NYSE's floor and sued NYSE in state court for state-law claims arising out of the suspension and related enforcement proceedings. NYSE removed the case to federal court, and the district court eventually dismissed the case with prejudice based on *Barbara*'s absolute-immunity ruling. *Id.* at 98.

On appeal, the Second Circuit again considered its jurisdiction *sua sponte*, and concluded that it had jurisdiction. Following an extended discussion of

Barbara, the court of appeals sought to distinguish *Barbara*'s *dicta*. According to *D'Alessio*, *Barbara* concerned only NYSE's application of its own supposedly contract-like rules, whereas the plaintiff in *D'Alessio* had alleged that NYSE violated not only its own rules, but also "the federal securities laws and various rules promulgated by [NYSE] and failed to perform its statutory duty, *created under federal law*, to enforce its members' compliance with those laws." 258 F.3d at 101.

But *D'Alessio* did not explain how this observation could distinguish the NYSE rules at issue in *Barbara*, which *Barbara* acknowledged *also* were established pursuant to the federal securities laws. *Barbara*, 99 F.3d at 54. And—without even acknowledging *Barbara*'s *dicta* that Section 27 does not provide an independent basis for federal jurisdiction—*D'Alessio* cited Section 27's exclusive jurisdiction as a "recognition" of the "importance of federal regulation of the stock market." 258 F.3d at 104 (citation omitted).

The Second Circuit's effective repudiation of *Barbara*'s jurisdictional *dicta* continued last year in *NASDAQ OMX Group* v. *UBS Securities, LLC*, 770 F.3d 1010 (2d Cir. 2014). In *UBS*, the plaintiff had initiated arbitration against NASDAQ pursuant to a clause in NASDAQ's service agreement, seeking damages under four state-law claims resulting from complications in Facebook's initial public offering. *Id.* at 1013–17. NASDAQ sued in federal court to enjoin the arbitration and for a declaratory judgment of immunity from suit. The district court issued a preliminary injunction, and the plaintiff appealed.

The Second Circuit relied on the four-part test for federal-question jurisdiction articulated in *Grable*

& Sons Metal Products, Inc. v. *Darue Engineering & Manufacturing*, 545 U.S. 308 (2005), and *Gunn* v. *Minton*, 133 S. Ct. 1059 (2013)—that is, whether the federal issue is "(1) necessarily raised, (2) actually disputed, (3) substantial, and (4) capable of resolution in federal court without disrupting the federal-state balance." *Gunn*, 133 S. Ct. at 1065. The Second Circuit concluded that the federal interests involved supported jurisdiction, and articulated a rule that could grant federal jurisdiction over nearly every claim related to the functioning of a stock exchange and its compliance with the regulatory regime superintended by the SEC. *UBS*, 770 F.3d at 1020–31.[6]

The federal issue raised and disputed was whether NASDAQ had satisfied its statutory obligation "to operate a fair and orderly market," 770 F.3d at 1021—an obligation created by the Exchange Act that would also cover investigation and discipline of the floor clerk in *Barbara*. The federal-state balance would not be disturbed because, according to the court, Section 27 demonstrated that Congress intended federal courts to adjudicate securities matters. *Id.* at 1030–31. As for "substantiality," the court of appeals identified simply "the central role stock exchanges play in the national system of securities markets." *Id.* at 1024.

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[6] This Court is not presented with the question whether Section 1331, under the *Grable-Gunn* analysis, would support federal jurisdiction in this case. Rather, the question presented is limited to whether Section 27 confers federal jurisdiction. Accordingly, this Court need not address *other* potential grounds for jurisdiction, such as Section 1331. *See, e.g.*, *UBS*, 770 F.3d at 1020–31.

Regarding this final category, the Second Circuit reconsidered *Barbara*'s essential premise: that SRO rules are supposedly "'contractual in nature'" and thus have little federal interest. 770 F.3d at 1025 (quoting *Barbara*, 99 F.3d at 54–55). The court correctly noted that *Barbara* had ignored the importance of SEC approval of SRO rules, which itself created a substantial federal interest in adjudicating alleged violations of those rules. *Id.* at 1026. The court explained away this oversight by emphasizing the "trifling significance" of the dispute in *Barbara*. *Ibid.* Notwithstanding *Barbara*'s logical shortcomings, as noted by the *UBS* court, *UBS* did not revisit *Barbara*'s *dicta* that Section 27 does not grant jurisdiction because the *Grable-Gunn* jurisdictional test had achieved the same result. *Id.* at 1030–31.

* * *

Whatever merit *Barbara*'s jurisdictional *dicta* might have had as originally decided—and the discussion above makes clear that it had none—the decision has been thoroughly undermined by subsequent decisions, and thus should have no persuasive force in this Court. Instead, this Court should rely on the plain text of Section 27 and the reasoning of cases applying the plain text, like *Sparta* and *Hawkins*, to hold that Section 27 is an affirmative and exclusive grant of jurisdiction that turns solely on whether the claims at issue satisfy one of the statute's two prongs, both of which are independent of the source of the cause of action or "state-law" label invoked by the plaintiff.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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September 10, 2015

No. 14-1132

SEP 16 2015

IN THE

Supreme Court of the United States

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., *et al.*,
Petitioners,

v.

GREG MANNING, *et al.*,
Respondents.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

BRIEF FOR THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

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INTEREST OF AMICUS CURIAE[1]

The Chamber of Commerce of the United States of America is the world's largest business federation. It represents 300,000 direct members and indirectly represents the interests of more than 3 million companies and professional organizations of every size in every industry sector, and from every region of the country. An important function of the Chamber is to represent the interests of its members before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files amicus curiae briefs in cases that raise issues of concern to the nation's business community.

As a business federation representing the interests of all industry sectors, there is a diversity of views among the Chamber's members about how the securities markets should be regulated, including with respect to the short selling practices allegedly at issue in this case. The Chamber has taken the position that short selling is an important activity needed for market liquidity. But the Chamber has also noted its serious concerns with manipulative short-selling tactics and abusive naked short selling, and has supported SEC efforts to curtail these activities.

Of course, to resolve this case this Court need not address whether naked short selling is good or bad, or whether and how it should be regulated. Rather, this Court is confronted only with whether the Securities

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[1] No counsel for a party authored this brief in whole or in part, and no entity or person, aside from amicus curiae, its members, and its counsel, made a monetary contribution intended to fund the preparation or submission of this brief. All parties to this matter have granted blanket consent for the submission of amicus curiae briefs in support of either or neither party.

Exchange Act (Exchange Act) creates exclusive federal court jurisdiction over state-law claims seeking to enforce standards created by the Act and its implementing regulations. On that score there is no doubt that federal regulations, such as Regulation SHO's restrictions on short selling, should be interpreted and enforced clearly, consistently, and predictably in the federal courts, and not in the state courts. The Third Circuit's decision to the contrary undermines the important goal of uniformity that Congress sought to achieve through section 27's exclusive jurisdiction provision.

The Chamber supports a modern, coherent financial services regulatory system that promotes uniformity and properly separates state and federal roles. The Third Circuit's interpretation of section 27 upsets this delicate federal-state balance, and risks imposing overlapping, contradictory, and duplicative requirements on businesses.

SUMMARY OF ARGUMENT

This Court should reverse the Third Circuit's decision and hold that the scope of federal jurisdiction under section 27 of the Exchange Act is broader than 28 U.S.C. § 1331 "arising under" jurisdiction, encompassing all suits that seek to enforce federal standards created by the Act and regulations thereunder, regardless of whether the claim alleged is one arising under state or federal law.

Section 27 of the Exchange Act is not simply an exclusivity provision, but affirmatively grants federal jurisdiction over both "violations of" the Act or its implementing regulations *and* "suits ... brought to enforce any liability or duty created by" the Act or its implementing regulations. 15 U.S.C. § 78aa(a). Unlike 28

U.S.C. § 1331, section 27 does not focus on whether the claim itself is created by or arises under federal law, but whether the alleged violations and duties underlying any claim are federal. Accordingly, respondents' complaint, which both expressly and by implication alleges violations of the Exchange Act's short selling regulation, Regulation SHO, is subject to federal jurisdiction pursuant to section 27.

Exclusive federal jurisdiction under section 27 advances the Exchange Act's goal of establishing an effective national securities market. The regulation of market structure requires considerable centralization and standardization, which are difficult to achieve without uniform federal-court interpretation and adjudication. The need for uniformity is particularly apparent in the regulation of "naked" short selling, which is embedded in the procedures governing the national system for clearance and settlement of securities transactions. Suits involving allegations of naked short selling necessarily involve interpretation of federal law, and demand considerable judicial expertise that state-court litigation cannot guarantee. The problem of inconsistent state-court application is further exacerbated by the artful pleading the Third Circuit's rule encourages. To avoid section 27's grant of exclusive federal jurisdiction, plaintiffs will not directly raise federal causes of action, but use federal law to inform state standards of care. This indirect approach to applying federal law is sure to create confusion, and risks subjecting market participants to uncertain and conflicting state and federal obligations.

ARGUMENT

I. SECTION 27 OF THE EXCHANGE ACT EXTENDS FEDERAL JURISDICTION TO ALL SUITS ALLEGING VIOLATIONS OF THE ACT OR SEEKING TO ENFORCE DUTIES CREATED BY THE ACT

A. Section 27 Is An Affirmative Grant Of Jurisdiction

Section 27 states that the federal district courts "shall have exclusive jurisdiction of violations of [the Exchange Act] or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by [the Act] or the rules and regulations thereunder." 15 U.S.C. § 78aa(a). Without analysis of the text, the Third Circuit concluded that section 27 is "coextensive" with 28 U.S.C. § 1331, and thus "merely serves to divest state courts of jurisdiction," with no "independent" jurisdictional effect. Pet. App. 22a.

This reading is inconsistent with the plain language of section 27. Consistent with that text, this Court has repeatedly observed over the last 50 years that section 27 is not just an exclusivity provision, but an affirmative grant of jurisdiction. *See, e.g.*, *Morrison* v. *National Australia Bank Ltd.*, 561 U.S. 247 (2010); *Touche Ross & Co.* v. *Redington*, 442 U.S. 560 (1979); *J.I. Case Co.* v. *Borak*, 377 U.S. 426 (1964).

Reference to the jurisdictional provisions of the other securities laws supports this conclusion. The Securities Act of 1933, the Investment Company Act of 1940, and the Investment Advisers Act of 1940 all contain jurisdictional provisions with language nearly identical to that of section 27, except that their jurisdictional grants are not "exclusive." 15 U.S.C. §§ 77v(a), 80a-43, 80b-14. Given the similarity in the language,

these provisions must be interpreted in the same way as section 27. But if the Third Circuit's interpretation of section 27 is applied to them, then they are rendered effectively meaningless—with neither independent jurisdictional effect nor the ability to divest state courts of jurisdiction.

The Court's statement in *Pan American Petroleum Corp.* v. *Superior Court of Delaware for New Castle County*, 366 U.S. 656 (1961), that "exclusiveness is ... not the generator of jurisdiction" does not support the Third Circuit's conclusion. *Id.* at 664. *Pan American* states the truism that the scope of exclusivity depends on the scope of the jurisdictional grant. That section 27 grants jurisdiction is unequivocal; the only question is what the scope of that jurisdiction is.

B. Section 27's Grant Of Exclusive Jurisdiction Is Not Coextensive With Section 1331

The starting point for determining the scope of section 27's jurisdictional grant is the text of the provision. Section 27 does not use the same language as 28 U.S.C. § 1331 ("The district courts shall have original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States."). Section 27 contains two jurisdiction-granting clauses: (1) for "violations of [the Exchange Act] or the rules and regulations thereunder" and (2) for "all suits ... brought to enforce any liability or duty created by [the Act] or the rules and regulations thereunder." 15 U.S.C. § 78aa(a).

The first clause refers simply to "violations" of the Exchange Act and its implementing rules and regulations. No reference is made to any specific cause of action, or whether that cause of action must be created by the federal securities laws. In the absence of such limi-

tation, the natural reading is that a suit premised on a violation of the Act or an implementing rule or regulation would be covered by the plain text of the clause regardless of whether the cause of action is rooted in federal or state law.

The second clause compels a similar reading. Although this clause does refer to "suits" and "actions," it does not require them to be created by or to arise under the Exchange Act. Instead, only the "liability or duty" underpinning the suit or action need be "created by" the Exchange Act. Again, a suit premised on enforcing a liability or duty created under the Act or its implementing rules or regulations would be covered. It is apparent that Congress intended to focus on the underlying violation, not the legal source of the cause of action.[2]

By contrast, courts have interpreted the language of 28 U.S.C. § 1331 as calling for a closer connection between federal law and the plaintiffs' cause of action. Although the phrase "arising under" "has resisted all attempts to frame a single, precise definition," "the most familiar definition ... is Justice Holmes' statement, 'A suit arises under the law that creates the cause of action.'" *Franchise Tax Bd. of State of Cal.* v.

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[2] The Court recognized a similar distinction in *Pratt* v. *Paris Gas Light & Coke Co.*, 168 U.S. 255, 259 (1897), a case on which *Pan American* relied heavily. In holding that the exclusive jurisdiction provision under the Patent Act did not prohibit state courts from resolving "questions" arising under the patent laws, the Court relied on the language of the provision, which only referred to "cases" arising under the patent laws. *Id.* The Court observed: "There is a clear distinction between a case and a *question* arising under the patent laws." *Id.* (emphasis added). Here, the distinction is between a "suit or action" and "liability or duty" created by the Exchange Act. The text only refers to an Exchange Act "liability or duty"; it is not limited to suits or cases, as are the Patent Act and 28 U.S.C. § 1331.

Constr. Laborers Vacation Trust for S. Cal., 463 U.S. 1, 8-9 (1983). In limited cases, a suit will also be found to be "arising under" federal law "where the vindication of a right under state law necessarily turned on some construction of federal law." *Id.* at 9.[3]

Section 27 does not require any such causal nexus. Instead of requiring the suit to "arise under" federal law, the text provides that any suit that seeks to determine a federal violation or enforce a federal duty under the Exchange Act would be covered. As a result, section 27 covers, for example, state RICO suits with federal securities law predicates and tort suits premised on violation of federal securities law standards.[4] Here, "[t]here is no question that Plaintiffs assert in their Amended Complaint, both expressly and by implication, that Defendants repeatedly violated federal law" and that "there is no New Jersey analogue to Regulation SHO." Pet. App. 9a. In addition, plaintiff

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[3] *See also Grable & Sons Metal Prods., Inc.* v. *Darue Eng'g & Mfg.*, 545 U.S. 308, 314 (2005) ("[T]he question is, does a state-law claim necessarily raise a stated federal issue, actually disputed and substantial, which a federal forum may entertain without disturbing any congressionally approved balance of federal and state judicial responsibilities.").

[4] Courts have held that under 28 U.S.C. § 1331, removal of such suits is not always permitted. *See, e.g., Merrell Dow Pharm. Inc.* v. *Thompson*, 478 U.S. 804, 805 (1986) (removal improper in negligence suit alleging violation of federal food labeling laws); *Adventure Outdoors, Inc.* v. *Bloomberg*, 552 F.3d 1290, 1298 (11th Cir. 2008) (removal improper in defamation suit requiring determination whether plaintiffs' conduct violated federal gun laws); *Ayres* v. *General Motors Corp.*, 234 F.3d 514, 519 (11th Cir. 2000) (declining to hold "that *every* state RICO cause of action which depends upon proving, as necessary predicate acts, a violation of the federal mail and wire fraud statutes establishes federal question jurisdiction"). But similar suits involving standards set by the Exchange Act would be subject to exclusive federal jurisdiction.

"couches its allegations in language that appears borrowed from Regulation SHO." *Id.* at 8a-9a. Although nominally a purely state case, plaintiffs' claims, in effect, seek enforcement of duties created by the Exchange Act. That is enough to satisfy section 27.[5]

Pan American is not to the contrary. That case simply applies the established principle of the well-pleaded complaint to hold that a federal issue that arises only in defense cannot create federal question jurisdiction. That is of no relevance here, as plaintiffs clearly seek to enforce duties created by Regulation SHO under the Exchange Act.

II. Uniformity In The Application Of The Exchange Act Is Critical For Effective Enforcement Of The Securities Laws And Efficient Administration Of Financial Markets

A. As A Law Governing Market Structure, The Exchange Act Must Be Uniformly Applied

Congress passed section 27 with the objective of "achiev[ing] greater uniformity of construction and more effective and expert application of that law.'"

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[5] Plaintiffs' careful efforts to avoid assertion of a federal claim should make no difference here. Under the "artful pleading" doctrine, removal may be proper "even though no federal question appears on the face of the plaintiff's complaint." *Rivet* v. *Regions Bank of Louisiana*, 522 U.S. 470, 475 (1998). This may occur when federal law "completely preempts" the state-law claim, *id.*, or when a state-law claim "omit[s] from the complaint federal law essential to his or her claim," *Easton* v. *Crossland Mortgage Corp.*, 114 F.3d 979, 982 (9th Cir. 1997). Although this doctrine is tailored towards 28 U.S.C. § 1331, the logic applies with particular force to section 27. Application of the "artful pleading" rule ensures that the plaintiff does not engage in a bait-and-switch, minimizing federal issues in the complaint, but ultimately relying on federal violations and duties to establish liability.

Matsushita Elec. Indus. Co. v. *Epstein*, 516 U.S. 367, 383 (1996).[6] The uniformity promoted by section 27 is central to achieving the Exchange Act's overarching goal of creating and "insur[ing] the maintenance of fair and honest markets," a goal that requires considerable centralization and standardization if such regulation is to be "reasonably complete and effective." 15 U.S.C. § 78b; *see also Merrill Lynch, Pierce, Fenner & Smith Inc.* v. *Dabit*, 547 U.S. 71, 78 (2006) ("The magnitude of the federal interest in protecting the integrity and efficient operation of the market for nationally traded securities cannot be overstated.").

A coherent national securities market system requires consistent procedures, coordination, and uniform rules to effectively operate. A key component of the Exchange Act's initial framework was the establishment of a uniform national system of registration, *see, e.g.*, 15 U.S.C. §§ 78f, 78*l*, 78o, 78s, and reporting, *see, e.g.*, *id.* §§ 78m, 78q. This standardization helped restore faith in the system after the 1929 stock market crash, and the securities markets "flourished[,] ... provid[ing] a means for millions of Americans to share in the profits of [the] free enterprise system and ... facilitat[ing] the raising of capital by new and growing businesses." H.R. Conf. Rep. No. 94-229, at 91 (1975), *reprinted in* 1975 U.S.C.C.A.N. 321, 322.

The need for uniformity in the national securities laws has only increased over time. In the 1970s, Congress concluded that the securities industry's failure to

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[6] By contrast, courts interpreting 28 U.S.C. § 1331, which covers all areas of federal law, must balance a "welter of issues regarding the interrelation of federal and state authority and the proper management of the federal judicial system." *Franchise Tax Bd.*, 463 U.S. at 8.

adapt to altered economic and technological conditions had resulted in "misallocation of capital, widespread inefficiencies, and undesirable and potentially harmful fragmentation of trading markets." S. Rep. No. 94-75, at 1 (1975), *reprinted in* 1975 U.S.C.C.A.N. 179, 180. As a result, Congress passed the Securities Acts Amendments of 1975, Pub. L. No. 94-29, 89 Stat. 141, which set out to "remove impediments to and perfect the mechanisms of a national market system for securities and a national system for the clearance and settlement of securities transactions." *Id.* § 2 (*codified at* 15 U.S.C. § 78b). The "[n]ational market system" would link all national securities markets, "foster[ing] efficiency, enhanc[ing] competition, and increas[ing] the information available" to all market participants. 15 U.S.C. § 78k-1(a)(1)(A)-(D). Likewise, the "[n]ational system for clearance and settlement of securities transactions," would link all clearance and settlement facilities and establish "uniform standards and procedures" to protect investors and reduce unnecessary costs. *Id.* § 78q-1(a)(1)(A)-(D). Congress did not contemplate regulation of these national systems by 50 different states, but charged the SEC with implementing these systems and promulgating regulations to ensure their orderly operation. *Id.* §§ 78k-1(a)(2), 78q-1(a)(2).

Piecemeal state regulation and interpretation risks undermining these national systems. For example, in a 1972 report on the securities industry, the Senate Subcommittee on Securities identified "a lack of uniformity and coordination among the various methods and systems of clearing and settlement," and "found an alarming lack of supervision, coordination, and central decision making which was delaying implementation of many of the technological innovations available to help solve processing problems." S. Rep. No. 94-75, at 54,

reprinted in 1975 U.S.C.C.A.N. at 232. Recognizing the difficulties of implementing a consistent national system, the Subcommittee recommended enacting legislation "prohibiting the imposition of state and local taxes" that were "inhibit[ing] unreasonably the development of an efficient national clearing and depository system." *Id.*; *see* 15 U.S.C. § 78bb(d). For similar reasons, state suits against financial institutions responsible for clearing and settlement would have an inhibiting effect if every procedural violation triggered state liability.

Achieving uniformity can be difficult enough even within the federal system; one of the 1975 amendments to the Exchange Act included "several provisions designed to assure cooperation among, and avoid regulatory duplication by, the several agencies which inspect and enforce compliance by municipal securities dealers." S. Rep. No. 94-75, at 53, *reprinted in* 1975 U.S.C.C.A.N. at 231. Similarly, the Senate Committee recommended that the SEC "serve as the central collection point" for data on institutional investors, in order to ensure that "uniform reporting standards can be established through coordination with other state and federal regulatory agencies to minimize, to the largest extent reasonably possible, the wasted costs and efforts associated with filing multiple reports." *Id.* at 85, *reprinted in* 1975 U.S.C.C.A.N. at 263-264. State suits involving the regulation of market structure would unnecessarily waste resources, further complicate the existing patchwork of regulators, and potentially upset this carefully calibrated scheme.

B. Uniformity Is Particularly Important For The Effective Regulation Of Naked Short Selling

These problems are particularly apparent in the realm of naked short selling.[7] Regulation SHO operates within, and is intimately related to, the national system for clearance and settlement of securities transactions. *See, e.g.*, 68 Fed. Reg. 62,972, 62,977 (Nov. 6, 2003) (Regulation SHO's delivery requirements "would protect and enhance the operation, integrity and stability of the markets and the clearance and settlement system ... by substantially curtailing naked short selling"). Regulation SHO does not establish broad, principles-based standards, but rather provides for detailed and technical rules governing market participants' conduct, including the "marking," 17 C.F.R. § 242.200(g), "locate," *id.* § 42.203(b), and "close-out" requirements, *id.* § 242.204. Accordingly, Regulation SHO sets forth precise num-

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[7] Short selling is "a security trading practice in which a party 'speculates that a particular stock will go down in price and seeks to profit from that drop.'" *Whistler Invs., Inc.* v. *Depository Trust & Clearing Corp.*, 539 F.3d 1159, 1162 (9th Cir. 2008). "The seller sells a security he does not own, borrows the security from a broker to meet the delivery obligation, and then purchases an identical security to return to the broker. If the security has declined in price between the sale and the purchase, the seller profits." *Id.* Short selling can be critical for efficient capital market functioning and development, but can also be used to manipulate and deliberately push down share prices. *ATSI Commc'ns, Inc.* v. *Shaar Fund, Ltd.*, 493 F.3d 87, 101 (2d Cir. 2007). "Naked" short selling "occurs when a seller sells a security without owning or borrowing it and does not deliver the security when due." *Whistler Invs.*, 539 F.3d at 1162-1163. Abusive naked short selling undermines investor confidence, deprives shareholders of voting rights, and drives down prices, although under certain circumstances, failures to deliver securities by the settlement date may be an acceptable consequence of legitimate market-making activity. *See* 68 Fed. Reg. 62,972, 62,977 (Nov. 6, 2003).

bers of days within which securities failures to deliver need to be closed out, the procedural consequences of fails to deliver, and numerous exceptions and provisos. *See, e.g.*, 17 C.F.R. § 242.203(b)(3), (3)(i) ("If a participant of a registered clearing agency has a fail to deliver position at a registered clearing agency in a threshold security for thirteen consecutive settlement days, the participant shall immediately thereafter close out the fail to deliver position by purchasing securities of like kind and quantity[.] ... *Provided, however*, that a participant ... which, prior to the effective date of this amendment, had been previously grandfathered from the close-out requirement in this paragraph (b)(3) ... shall close out that fail to deliver position within thirty-five consecutive settlement days of the effective date of this amendment."). These intricate procedural rules call for consistent and expert adjudication, not ad hoc interpretation by unfamiliar state courts.

What constitutes manipulative behavior depends in part on the SEC rules in place, including the definition of "naked" short sale itself, which is keyed off of the time within which a contract settles, typically three days under Rule 15c6-1. 17 C.F.R. § 240.15c6-1(a). Furthermore, manipulative naked short selling schemes are often designed around existing rules—for example, an investor may try to circumvent the requirements of Regulation SHO by taking advantage of high borrowing costs in hard-to-borrow securities. *See* SEC, Office of Compliance Inspections and Examinations, *Risk Alert* (Aug. 9, 2013).[8] The regulation of short selling is not static; since its passage in 2004, Regulation SHO has been amended five separate

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[8] *Available at* http://www.sec.gov/about/offices/ocie/options-trading-risk-alert.pdf.

times.[9] Even the most experienced state courts will have difficulty ensuring that the alleged theories of fraud remain consistent with these developments.

Any state suit alleging naked short selling, therefore, would necessarily involve interpretation and application of these procedures governing clearance and settlement. If state courts are regularly interpreting such procedures, inconsistencies are bound to arise, undermining the effectiveness of the procedures. An effective short selling procedural regime requires "regulatory simplification and uniformity"; the SEC has noted the importance of avoiding "inconsistent short sale regulation of securities, depending on the market where the securities are trading, and the type of short selling activity." 71 Fed. Reg. 75,068, 75,080 (Dec. 13, 2006). Indeed, "[d]isturbances in settlement processes can affect the stability and integrity of the financial system in general. Clearance and settlement systems are designed to preserve financial integrity and minimize the likelihood of systematic disturbances by instituting risk-management systems." 68 Fed. Reg. 62,972, 62,991 (Nov. 6, 2003).

Not only are markets dependent on consistent procedures, protocols, and rules, but they are highly sensitive to the trust and fears of individual investors. The inconsistent and unpredictable regulation that would result from state court adjudication may provoke market participants into taking matters to their own hands, at the cost of overall market integrity:

> Naked short selling has sparked defensive actions by some issuers designed to combat the

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[9] *See* 72 Fed. Reg. 36,348 (July 3, 2007); 72 Fed. Reg. 45,544 (Aug. 14, 2007); 73 Fed. Reg. 61,690 (Oct. 17, 2008); 74 Fed. Reg. 38,266 (July 31, 2009); 75 Fed. Reg. 11,232 (Mar. 10, 2010).

> potentially negative effects on shareholders, broker-dealers, and the clearance and settlement system. Some issuers have taken actions to attempt to make transfer of their securities "custody only," thus preventing transfer of their stock to or from securities intermediaries such as the Depository Trust Company (DTC) or broker-dealers. A number of issuers have attempted to withdraw their issued securities on deposit at DTC, which makes the securities ineligible for book-entry transfer at a securities depository. Withdrawing securities from DTC or requiring custody-only transfers undermine the goal of a national clearance and settlement system, designed to reduce the physical movement of certificates in the trading markets.

68 Fed. Reg. 62,972, 62,975 (Nov. 6, 2003).

It is no response that Congress contemplated an ongoing role for state blue-sky laws after passing the Exchange Act. *See* 15 U.S.C. § 78bb(a)(1) ("Except as otherwise specifically provided in this title, nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations under this chapter."). First, the preservation of jurisdiction for state securities commissioners in section 28 of the Exchange Act applies only to the extent the exercise of that state jurisdiction does not conflict with federal law. Further, section 28 is expressly made subject to other provisions in the Exchange Act, and section 27 makes clear that, even absent a conflict between state and federal law, a state action that relies on federal standards is to be resolved in federal court. When suits are brought in state

court to enforce only state standards created by state law, it is unlikely that section 27 would deprive the state courts of jurisdiction. For example, there may be no need to reference the Exchange Act's general fraud provision, § 10(b), in making out a state law fraud claim. *Id.* § 78j (prohibiting use of "manipulative or deceptive device or contrivance" "in connection with sale of security"). But when a plaintiff does rely on federal standards to prove a state law claim, including a state law fraud claim, section 27 is triggered. Where there is a risk of inconsistent application of federal law, and therefore a risk of undermining regulation of national markets, exclusive jurisdiction is appropriate.

C. The Third Circuit's Rule, Which Encourages Artful Pleading, Creates A Substantial Risk Of Inconsistency In The Application Of The Securities Laws

As discussed above, any state court interpretation of federal standards has the potential to undermine the efficient operation of national market structures. The Third Circuit's rule, however, is particularly likely to lead to disruptive consequences, with the perverse result that section 27's exclusivity provision increases the variance in application of the law.

In cases involving concurrent state-federal jurisdiction, federal law is subject to interpretation by more than 50 different court systems. But the potential for inconsistency is mitigated because every court is applying the same law (albeit under different procedural regimes).

The Third Circuit's regime is more complicated. Because section 27 is exclusive, plaintiffs must avoid pleading federal causes of action in their state court suits. But under the Third Circuit's reading, section 27

would broadly allow injection of federal rules and standards into those state court suits. Like the Exchange Act, state blue-sky laws broadly recognize claims for fraud and manipulation, which can be shown in myriad ways. *See, e.g.*, N.J. Stat. Ann. § 49:3-52.1(a)(5) (a person may not "employ any other deceptive or fraudulent device, scheme, or artifice to manipulate the market in a security"). Given the breadth of such a claim, a plaintiff would have no difficulty couching a federal violation in state terms. Unfortunately, the plaintiff would not be pleading the claim directly. As a result, the state court would be interpreting federal standards, but ultimately applying state law. This poses a serious threat to nationwide consistency; as the Third Circuit noted, New Jersey, for example, "has not shied away from deviating from federal law." Pet. App. 14a. Where federal standards are only indirectly incorporated into state adjudications, securities market participants are all but certain to face unpredictable and inconsistent interpretations of the law. Congress's intent in make section 27 exclusive was not to subject market participants to conflicting state and federal obligations, but to bring a measure of uniformity to the regulation of national securities markets. Accordingly, section 27 must be construed to cover all cases that seek to enforce federal securities law standards.

CONCLUSION

For the foregoing reasons, the decision of the Third Circuit should be reversed.

Respectfully submitted.

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SEPTEMBER 2015

Supreme Court, U.S.
FILED
SEP 10 2015
OFFICE OF THE CLERK

No. 14-1132

In the Supreme Court of the United States

MERRILL LYNCH, PIERCE, FENNER & SMITH, INCORPORATED, *et al.*,
Petitioners,

v.

GREG MANNING, *et al.*,
Respondents.

On a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF OF NATURAL GAS SUPPLY ASSOCIATION, WESTERN POWER TRADING FORUM AND ELECTRIC POWER SUPPLY ASSOCIATION AS AMICI CURIAE IN SUPPORT OF PETITIONERS

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INTEREST OF *AMICI CURIAE*[1]

The Natural Gas and Electric Power Industry *Amici* listed below respectfully submit this brief in support of Petitioners:

The Natural Gas Supply Association ("NGSA") is a trade association that represents integrated and independent companies that produce and market natural gas. Established in 1965, NGSA encourages the use of natural gas within a balanced national energy policy, and promotes the benefits of competitive markets to ensure reliable and efficient transportation and delivery of natural gas and to increase the supply of natural gas to U.S. customers. Members of the NGSA account for approximately thirty percent of the domestic natural gas production and are shippers on interstate pipelines.[2]

Western Power Trading Forum ("WPTF") is a California non-profit, public benefit corporation. Its broad-based membership includes energy service providers, scheduling coordinators, generators, power marketers, financial institutions, energy consultants and public utilities dedicated to enhancing competition in Western electric markets

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[1] No counsel for a party has authored this brief in whole or in part, and no person or entity other than *amici* or their counsel made any monetary contribution intended to fund the preparation or submission of this brief. A blanket consent letter on behalf of all parties is on file with this Court.

[2] This brief represents the position of NGSA, WPTF and EPSA as organizations, but not necessarily the views of any particular member of such organizations with respect to any issue.

while maintaining the region's current high level of system reliability.

The Electric Power Supply Association ("EPSA") is a national trade association that represents the competitive power industry. EPSA's members include 14 companies, along with numerous supporting members, and state and regional partners representing the competitive power industry in their respective regions. EPSA's members have significant financial investments in electric generation and electricity marketing operations across the country.

INTRODUCTION AND SUMMARY OF ARGUMENT

A. The Court's construction of the exclusive jurisdiction provision of the Securities Exchange Act of 1934 ("Exchange Act") in this case will impact the interpretation of the substantially identical exclusive jurisdiction provisions contained in the Federal Power Act and the Natural Gas Act. Like § 27 of the Exchange Act, § 317 of the Federal Power Act, 16 U.S.C. § 825p, and § 24 of the Natural Gas Act (formerly § 22), 15 U.S.C. § 717u, mandate that federal courts "shall have exclusive jurisdiction of violations of" each Act and regulations promulgated thereunder, and "of all suits in equity and actions at law brought to enforce any liability or duty created by" those statutes and the associated regulations. *Amici* represent a broad cross-section of the natural gas and electric power industries that will be directly and significantly impacted by this Court's decision.

B. The Federal Power Act creates a uniform, nationwide framework that empowers the Federal Energy Regulatory Commission ("FERC") to regulate the interstate transmission and wholesale sale of electric energy. The Natural Gas Act similarly creates a uniform, nationwide framework that empowers FERC to regulate the interstate transportation and certain wholesale sales of natural gas.[3] In support of those objectives, both statutes provide for exclusive jurisdiction in the federal courts over [1] causes of action expressly arising under the Natural Gas Act and Federal Power Act, and [2] causes of action that seek to enforce statutory or regulatory "duties" or "liabilities" under those Acts. The first category of cases includes express causes of action under the Natural Gas Act and Federal Power Act, which fall under the "arising under" jurisdiction of the federal courts. The second category of cases captures causes of action that rely on a "duty" or "liability" created by the Natural Gas Act, Federal Power Act or FERC regulation, but are not federal causes of action expressly authorized by those statutes. (In fact, there are no implied rights of action under either the Federal Power or Natural Gas Acts.) These exclusive jurisdictional grants further the interest of uniformity by ensuring that federal judges—and only federal judges—guided and bound by more than seven decades of federal precedent, construe these intricate and complex

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[3] FERC's regulatory authority does not apply to all sales of natural gas at wholesale. Section 601(a)(1) of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3431(a)(1), removed "first sales" of natural gas from FERC regulation under the Natural Gas Act.

federal regulatory frameworks consistently and authoritatively.

As under the Exchange Act, private plaintiffs—and occasionally state attorneys general—have attempted to create state-law causes of action based on statutory and regulatory duties and liabilities under the Natural Gas Act and Federal Power Act. For example, California's Attorney General attempted to bring a state-law cause of action against various power companies in state court based on alleged violations of federal tariffs approved by FERC. *See California ex rel. Lockyer v. Dynegy, Inc.*, 375 F.3d 831 (9th Cir. 2004). The Ninth Circuit concluded that § 317 of the Federal Power Act required that claim to be brought exclusively in federal court, because the claim was nothing more than a "naked attempt to enforce these federal obligations." *Id.* at 843.

The Third Circuit (and the Second Circuit before it), however, concluded that § 27 of the Exchange Act does *not* create an independent basis for federal jurisdiction. According to the Second and Third Circuits, federal "arising under" jurisdiction must exist independently under 18 U.S.C. § 1331 by virtue of a federal claim; the exclusive jurisdiction statutes do not *create* an independent basis for federal jurisdiction. Under this view, the only relevance of the exclusive jurisdiction statutes is that if there is federal "arising under" jurisdiction under 18 U.S.C. § 1331, due to the presence of a federal claim under the Exchange Act (and by implication, under the Federal Power and Natural Gas Acts), federal courts have *exclusive* jurisdiction over those

claims, rather than share concurrent jurisdiction with state courts.

The Second and Third Circuits, however, never attempted to grapple with the second category of claims that are based on "duties" and "liabilities" under the Exchange Act or its regulations. That is because they concluded, erroneously, that the question previously had been resolved by this Court under the Natural Gas Act's exclusive jurisdiction provision in *Pan American Petroleum Corp. v. Superior Court of Delaware*, 366 U.S. 656 (1961).

C. *Pan American*, however, never addressed the meaning of the second category of cases over which federal courts have exclusive jurisdiction under the Natural Gas Act, because the Court had no occasion to do so. There, the plaintiff sued the defendants for simple breach of contract under state law. Unlike in this case, the plaintiff did not purport to incorporate a federal duty into its state-law cause of action. Rather, the defendants argued that they intended to rely on a federal regulation—an order by the Federal Power Commission accepting a rate schedule—as part of their defense. The defendants nonetheless argued that they should be permitted to remove the case to federal court because they would be raising a federal defense. Writing for the Court, Justice Frankfurter rejected this argument, because federal jurisdiction must be evaluated on the face of the plaintiff's complaint, the now familiar well-pleaded complaint rule. Further, the defendants' reliance on the Natural Gas Act's exclusive jurisdiction clause was misplaced, because it did not alter the fact that federal jurisdiction must be evaluated based on the

plaintiff's claim. Thus, *Pan American* observed that "'[e]xclusive' jurisdiction is given the federal courts but it is 'exclusive' only for suits that may be brought in the federal courts. Exclusiveness is a consequence of having jurisdiction, not the generator of jurisdiction because of which state courts are excluded." *Id.* at 664. Therefore, the plaintiff's case could not have been commenced in federal court, because the plaintiff asserted only a state-law breach of contract claim. Accordingly, the Natural Gas Act's exclusive jurisdiction clause was beside any relevant point.

Properly read, *Pan American* does not control the outcome of this case. Indeed, *Pan American* does not even address the question of statutory construction presently before the Court: Whether the exclusive jurisdiction statutes create an independent basis for federal jurisdiction over state-law claims based on alleged breaches of "duties" or "liabilities" created by any of the Exchange Act, the Federal Power Act, the Natural Gas Act and their regulations? The answer is plainly "Yes," because finding otherwise would render the words "duties" and "liabilities" utterly meaningless. By ignoring those words, the Third Circuit's decision means that an entire category of cases construing duties and liabilities under federal statutes and regulations will now remain in state court. In the context of the Natural Gas and Federal Power Acts, the Third Circuit's holding threatens to disrupt the wholesale energy industry. It will now be necessary to survey the law of all of the states to determine how provisions of tariffs on file with FERC may be interpreted and thus the standard with which the

industry must comply. The resulting piecemeal, state-by-state, state court litigation will erode the very predictability and certainty that Congress intended to promote through the uniform enforcement in federal court of duties and liabilities created by the Acts.

D. This result is untenable because Congress established a uniform, nationwide framework to avoid the confusion, inefficiency and unfairness that arise when interstate commerce is subject to separate (and potentially conflicting) regulation by 49 jurisdictions (the 48 contiguous states, excluding portions of Texas, plus the District of Columbia) in which natural gas and electricity are transmitted and sold at wholesale in interstate commerce. Unless reversed by this Court, the decision in this case will engender uncertainty in the energy industry that will interfere with long-term planning, encourage litigation and forum-shopping, and increase energy costs.

It is for these reasons that the Natural Gas and Electric Power Industry *Amici* urge this Court to overturn the Third Circuit's decision.

ARGUMENT

I. The Natural Gas Act And Federal Power Act Contain Federal Jurisdiction Conferring Provisions Meant To Ensure The Uniform Enforcement, Interpretation And Application Of Those Statutes

A. The Natural Gas Act and Federal Power Act Provide Uniform, Nationwide Frameworks for Regulating Interstate Energy Transactions

In the early 20th Century, "the States possessed broad authority to regulate public utilities, but this power was limited by our cases holding that the negative impact of the Commerce Clause prohibits state regulation that directly burdens interstate commerce." *New York v. FERC*, 535 U.S. 1, 5 (2002) (discussing *Public Util. Comm'n of R.I. v. Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927)). Congress enacted the Federal Power and Natural Gas Acts to fill this gap to regulate the interstate commerce of the transmission and transportation, and the sale at wholesale, of electricity and natural gas. *Id.* at 6; *Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375 (1983). Although the sale and delivery of electricity and natural gas occurred primarily on a local and intrastate basis when Congress enacted these statutes, *see, e.g., New York v. FERC*, 535 U.S. 1, 5 (2002), Congress concluded that there was an increasing need to fill this gap as the interstate trade in electricity and natural gas expanded. *See, e.g.*, S. Rep. No. 621, 74th Congress, 1st Session, p. 17 (noting "the rapid development of the electric industry along lines that

transcend State boundaries" such that "[t]he amount of energy which flowed in interstate commerce in 1933 exceeded the entire amount generated in the country in 1913"); H.R. Report No. 709, 75th Congress, 1st Session, p. 2 (observing in 1937 the "substantial development" of the interstate transportation of natural gas after 1926). The combination of these reasons led Congress to declare that "Federal regulation is necessary in the public interest" for "the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce," 16 U.S.C. § 824(a), and "the transportation of natural gas and the sale thereof in interstate and foreign commerce." 15 U.S.C. § 717(a).

Since the enactment of the Federal Power and Natural Gas Acts, the volume of electricity and natural gas sold at wholesale in interstate commerce and transmitted or transported in interstate commerce has expanded significantly. This evolution has been facilitated by and developed in conjunction with changes in the regulatory framework implemented by the federal government pursuant to these statutes. As a result, the transmission of electricity and transportation of natural gas in interstate commerce, as well as the sale of electricity and natural gas within FERC's jurisdiction, are increasingly governed by tariffs of general applicability and ever more detailed FERC-promulgated regulations.

"Electricity," for instance, "is now delivered over three major networks, or 'grids,' in the continental United States." *New York*, 535 U.S. at 7. Electricity that enters these grids "immediately

becomes a part of a vast pool of energy that is constantly moving in interstate commerce." *Id.* To facilitate just and reasonable rates and mitigate undue discrimination in this transformed industry, "FERC adopted a pro forma Open Access Transmission Tariff (OATT), containing minimum terms and conditions for non-discriminatory service, which every transmission-owning public utility must file with the Commission and by which it must abide in providing transmission services to itself and others." *Transmission Access Policy Study Group v. FERC*, 225 F.3d 667, 727 (D.C. Cir. 2000). FERC also codified its standards for authorizing market-based rate sales of electricity at wholesale, and created standardized provisions required to be included in individual market-based rate tariffs.

FERC also has authorized the creation of independent system operators and regional transmission organizations, individual entities that operate the transmission system and administer organized wholesale electricity markets. *NRG Power Mktg. v. Maine Pub. Utils. Comm'n*, 558 U.S. 165, 169 n.1 (2010). These systems are designed to increase competition and market efficiency for trading electricity at wholesale and to facilitate the transmission of electricity over longer distances, resulting in lower prices. Each such organization operates an area consisting of numerous electric utilities as a unified system, often over multiple states and affecting bordering regions, pursuant to tariffs on file with FERC. *Id.* (quoting *Midwest ISO Transmission Owners v. FERC*, 373 F.3d 1361, 1364 (D.C. Cir. 2004) (explaining how independent system operators provide service pursuant to "'a single,

unbundled, grid-wide tariff")). Interpretation of each such tariff impacts the hundreds of market participants and transmission customers within each region.

The natural gas industry also has experienced dramatic transformations. In 1978 and 1989, for instance, Congress "substantially narrowed" FERC's jurisdiction by removing "first sales" of natural gas from FERC's rate-setting authority. *See Amendments to Blanket Sales Certificates*, 68 Fed. Reg. 66,323, 66,325 (Nov. 17, 2003) (citing Natural Gas Policy Act of 1978, 15 U.S.C. § 3301 et seq., and Natural Gas Wellhead Decontrol Act of 1989, Pub. L. No. 101-60, 103 Stat. 157). In Order No. 636,[4] FERC required interstate natural gas pipelines to "unbundle" their transmission and sale of natural gas at wholesale services and to require pipelines to provide open and equal access to all shippers. As with electric transmission, natural gas transportation in interstate commerce is governed by FERC-filed tariffs of general applicability, which provide the terms and conditions of service by which the pipelines and shippers must comply. FERC's Order No. 636 also allowed entities to make jurisdictional sales of natural gas at market rates

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[4] *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Part 284 of the Commission's Regulations*, Order No. 636, 59 FERC ¶ 61,030 (1992), *order on reh'g*, Order No. 636-B, January 1991-June 1996 FERC Stats. & Regs. ¶ 61,272 (1992), *reh'g denied*, 62 FERC ¶ 61,007 (1993), *aff'd in part and remanded in part sub nom. United Distrib. Cos. v. FERC*, 88 F.3d 1105 (D.C. Cir. 1996), *order on remand*, Order No. 636-C, 78 FERC ¶ 61,186 (1997), *order on reh'g*, Order No. 636-D, 83 FERC ¶ 61,210 (1998).

pursuant to blanket certificates. These policy changes led to a substantial increase in the number of large gas customers purchasing natural gas from entities other than the local distribution companies and acting as shippers on interstate pipelines.

In recent years, Congress has reiterated the increasingly interstate and national nature of the power and natural gas industries in how it has amended FERC's regulatory authority. In the Energy Policy Act of 2005, Congress amended the Federal Power and Natural Gas Acts to grant FERC the authority to promulgate regulations to prohibit market manipulation, 16 U.S.C. § 824v and 15 U.S.C. § 717c-1, borrowing language from the Exchange Act; to expand dramatically FERC's civil penalty authority under both statutes to up to $1 million per violation, per day, 16 U.S.C. § 825o and 15 U.S.C. § 717t; and to regulate the reliability of the bulk-power system. 16 U.S.C. § 824o.

Congress recognized when enacting the Federal Power and Natural Gas Acts, and underscored when amending these statutes in 2005, that the success of our interstate energy markets depends, in significant part, on the maintenance of a uniform and national regulatory regime for certain sales at wholesale and transmission in interstate commerce. That regime relies on a consistent body of federal case law enforcing the liabilities and duties created by these two statutes. The transformation of the regulatory regime under these statutes, with an increasing importance of jurisdictional service governed by standardized tariff provisions and FERC-promulgated regulations, further underscores the growing need for exclusive federal jurisdiction

over causes of action that require interpretation of these complex and technical requirements with obvious interstate and national implications.

B. The Natural Gas Act and Federal Power Act Exclusive Jurisdiction Provisions Reinforce Congress' Objectives of Creating Uniform Regulatory Frameworks for the Natural Gas and Electricity Industries

In furtherance of Congress' goal of creating uniform regulatory regimes for interstate transportation or transmission and wholesale sales of natural gas and electricity, § 24 of the Natural Gas Act and § 317 of the Federal Power Act each provides that the federal courts

> shall have *exclusive jurisdiction* of violations of [the Act] or the rules, regulations and orders thereunder, and *of all suits* in equity and actions at law *brought to enforce any liability or duty created by, or to enjoin any violation of, this chapter or any rule, regulation or order thereunder...*"

15 U.S.C. § 717u; 16 U.S.C. § 825p (emphasis added). This language is substantially identical to § 27 of the Exchange Act.

As in all cases, the statutory text serves as the starting point for an inquiry into its meaning. *Gross v. FBL Fin. Servs., Inc.*, 557 U.S. 167, 175 (2009). If the language of a statute is plain and unambiguous, it must be given effect and enforced according to its terms. *See Hardt v. Reliance Standard Life Ins. Co.*, 560 U.S. 242, 251 (2010).

The language of §§ 24 and 317 is plain and unambiguous. The only reasonable interpretation of these provisions is that Congress empowered federal courts with the exclusive jurisdiction to decide not only cases "arising under" the statutes, but also those implicating the liabilities and duties established by the Natural Gas and Federal Power Acts. *See Lynch v. Alworth-Stephens Co.*, 267 U.S. 364, 370 (1925) ("The plain obvious and rational meaning of a statute is always to be preferred. . . ."); *Pensacola Telegraph Co. v. Western Union Telegraph Co.*, 96 U.S. 1, 12 (1878) (the Court must presume that lawmakers use words in "their natural and ordinary significance."). The natural reading of the text indicates that federal courts have exclusive jurisdiction of (1) violations of the Natural Gas and Federal Power Acts, and their implementing regulations, and (2) all suits in equity and actions at law brought to enforce any liability or duty created by the Acts. There is no reason to assume that Congress was just repeating itself by referring separately to "duties" and "liabilities." Courts must construe statutes so as to avoid rendering any part superfluous. *See Astoria Federal Sav. & Loan Ass'n v. Solimino*, 501 U.S. 104, 112 (1991); *see also Bailey v. United States*, 516 U.S. 137, 146 (1995) ("We assume Congress used two terms because it intended

each term to have a particular, non-superfluous reading.").

This reading of the text also makes sense. Providing exclusive federal jurisdiction over disputes relating to the interstate aspects of the natural gas and power industries furthers Congress' objective of creating a nationally uniform regulatory regime for wholesale sales and transmission in interstate commerce. In doing so, Congress plainly hoped to avoid the confusion, cost, and potential for conflict that would arise if state court judges under the guise of their particular state's laws were permitted to construe the meaning of duties and liabilities created by the Natural Gas and Federal Power Acts and FERC regulations.

C. The Third Circuit Did Not Attempt to Construe the Meaning of "Duties" and "Liabilities," and Essentially Rendered Them Meaningless

The Third Circuit recognized that the issue before it was "whether the exclusive jurisdiction provision in § 27 of the Exchange Act might nonetheless provide a more expansive basis [than 18 U.S.C. § 1331] for federal-question jurisdiction." Pet. App. 18a. But the Third Circuit did not attempt to construe the portion of § 27 that confers exclusive federal jurisdiction over claims that seek to enforce a liability or duty created by the Exchange Act or its regulations.

Rather than construe the actual language of § 27, the Third Circuit "believe[d] that the Supreme Court all but answered this question in *Pan*

American Petroleum Corp. v. Superior Court of Delaware In & For New Castle County, 366 U.S. 656 (1961)." *Id.* at 19-20a.[5] According to the Third Circuit, "[i]n reality, *Pan American* stands for the proposition that cases otherwise falling outside the scope of the district courts' *original jurisdiction* are not brought within it by virtue of an exclusive jurisdiction provision." Pet. App. 21a n.10. The Third Circuit therefore expressly followed the Second Circuit's decision in *Barbara v. New York Stock Exchange, Inc.*, 99 F.3d 49, 55 (2d Cir. 1996), and concluded that § 27 of the Exchange Act "is coextensive with § 1331 for purposes of establishing subject-matter jurisdiction—the exclusive jurisdiction provision merely serves to divest state courts of jurisdiction." Pet. App. 22a. In doing so, the Third Circuit expressly disagreed with decisions of the Ninth Circuit in *California ex rel. Lockyer v. Dynegy, Inc.*, 375 F.3d 831, 841 (9th Cir. 2004), and the Fifth Circuit in *Hawkins v. National Ass'n of*

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[5] Although not presently before the Court, the three-part test set forth in *Grable & Sons Metal Products, Inc. v. Darue Engineering & Manufacturing*, 545 U.S. 308 (2005), may provide an independent basis for federal jurisdiction over state-law claims based on "duties or liabilities" created by either the Federal Power Act or the Natural Gas Act. Under *Grable*, federal jurisdiction exists in the absence of an express or implied right of action, when (1) the state-law claim necessarily raises a disputed federal issue; (2) the federal interest in the issue is substantial; and (3) the exercise of jurisdiction does not disturb any congressionally approved balance of federal and state judicial responsibility. 545 U.S. at 314. Where, as here, Congress has provided for exclusive federal jurisdiction over claims based on duties and liabilities created by the Federal Power and the Natural Gas Acts, the *Grable* inquiry is unnecessary.

Securities Dealers Inc., 149 F.3d 330, 331-32 (5th Cir. 1998) (per curiam), that reached the conclusion that the exclusive jurisdiction provision is broader than § 1331.

The Third Circuit's reliance on *Pan American* was misplaced, because that case did not resolve the issue presented here.

II. *PAN AMERICAN* DID NOT ADDRESS EXCLUSIVE FEDERAL JURISDICTION OVER "DUTIES" AND "LIABILITIES" CREATED BY THE NATURAL GAS ACT

A. Pan American

As an initial matter, *Pan American* was *not* a case *decided* under the Natural Gas Act. The plaintiff, a natural gas pipeline company, entered into contracts to purchase natural gas from the defendant producers of natural gas. *Pan American*, 366 U.S. at 658. At the time the contracts were entered into, FERC's predecessor, the Federal Power Commission ("FPC"), did not assert jurisdiction over such sales. A state commission subsequently issued an order fixing the minimum price for gas *above* the prices originally agreed to by the contracting parties. *Id.* The pipeline sought judicial review of that order, but, pending the outcome of the dispute, agreed to pay the natural gas producers at the higher rate ordered by the state commission. *Id.* at 658-59. Subsequently, this Court held that, pursuant to the Natural Gas Act, the FPC was required to regulate wholesale sales by natural gas producers. *Id.* at 660 (citing *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672, 682 (1954)). Accordingly, following that

decision, the FPC ordered natural gas producers to file their rate schedules for such transactions. *Id.* The defendants in *Pan American* did so by filing the contracts with, among other things, the state commission minimum rate orders. *Id.* Thereafter, this Court, citing *Phillips*, invalidated the state supreme court's decision upholding the minimum rate order raising the price of natural gas above the contract price. *Id.* (citing *Cities Serv. Gas Co. v. State Corp. Comm'n*, 355 U.S. 391 (1958)).

The pipeline company later commenced an action in Delaware state court, asserting state-law breach of contract claims for the producers collecting rates higher than those originally agreed to in the bilaterally-negotiated contracts. *Id.* at 661. The natural gas producers challenged the jurisdiction of the state courts in view of the rate schedules on file with the FPC. According to the natural gas producers, "[s]ince the suits instituted by [the pipeline company plaintiff] involve rates so filed, they must either be to enforce a filed rate or to challenge a filed rate." *Pan American*, 266 U.S. at 662. The natural gas producers argued that, if the former, the claims were subject to the "exclusive jurisdiction" provision of the Natural Gas Act. The Supreme Court of Delaware rejected this argument because the pipeline company's claims "are not founded upon any liability *created* by the Natural Gas Act, but upon a private contract deriving its force from state law." *Id.* at 661.

This Court affirmed the Delaware Supreme Court's decision. Writing for the Court, Justice Frankfurter explained that "questions of federal jurisdiction and ouster of jurisdiction of state courts

are ... not determined by ultimate substantive issues of federal law. The answers depend on the particular claims a suit makes in state court – on how he casts his action." *Id.* at 662. This, of course, is nothing more than the well-pleaded complaint rule. The fact that the natural gas companies intended to raise a federal defense did not thereby create federal jurisdiction; jurisdiction must be evaluated on the face of the plaintiff's claim. And, Justice Frankfurter observed, the complaints in the Delaware state court only sought "recovery on alleged contracts to refund overpayments in the event of a judicial finding that the Kansas minimum rate order was invalid, or for restitution of the overpayments by which petitioners have allegedly been unjustly enriched under the compulsion of the invalid Kansas order. No right is asserted under the Natural Gas Act." *Id.* at 662-63.

The Natural Gas Act's exclusive jurisdiction provision did not alter that analysis, because the plaintiff's claim was not brought under the Natural Gas Act:

> "Exclusive jurisdiction" is given the federal courts but it is "exclusive" only for suits that may be brought in the federal courts. Exclusiveness is a consequence of having jurisdiction, not the generator of jurisdiction because of which state courts are excluded.

Id. at 664.

The Court then cited another state-law breach of contract case, in which the defendant asserted patent invalidity under the federal patent laws as a defense. *Id.* (citing *Pratt v. Paris Gas Light & Coke Co.*, 168 U.S. 255 (1897)). In that case, the Court had concluded that the exclusive jurisdiction clause in the patent laws did not "deprive the state courts of the power to determine *questions* arising under the patent laws, but only of assuming jurisdiction of 'cases' arising under those laws. There is a clear distinction between a case and a question arising under the patent laws." *Id.* And this is really what *Pan American* is about: The mere presence of a federal *issue* in a case arising by way of a defense does not create federal jurisdiction. Rather, jurisdiction must be evaluated on the face of the *claim* in the case.

The plain import of *Pan American* is that merely setting up a potential *defense* under the Natural Gas Act does not fundamentally alter the state-law nature of a breach of contract claim. Justice Frankfurter's reference to § 24 (then § 22) of the Natural Gas Act as not serving as a "generator of jurisdiction" must be understood in this light. Put another way, the Natural Gas Act's exclusive jurisdiction provision did not supplant the well-pleaded complaint rule.[6]

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[6] Justice Frankfurter notes that the Natural Gas Act's legislative history refers to "arising under" jurisdiction under § 24, the first part of the statute relating to express causes of action under the Natural Gas Act. *See Pan American*, 366 U.S. at 665 n. 2. The legislative history, however, does not refer to exclusive jurisdiction over causes of action that incorporate "duties" and "obligations" under the Natural Gas Act. *See* H.R.

Pan American plainly addressed an entirely different situation than the instant case. Here, following the well-pleaded complaint rule, the centerpiece of the Respondents' complaint is the purported violation of the SEC's Regulation SHO. This is *not* a case, like *Pan American*, in which a defendant is seeking to remove a state-law claim involving a claimed right "created by the state," *id.* at 664, to federal court based on a likely federal defense. Rather, this is a case where a plaintiff has expressly premised its state-law claim on the breach of a "duty" or "liability" created by a federal regulation. In other words, the well-pleaded complaint implicates federal jurisdiction. Under the plain terms of the exclusive jurisdiction provision, *that* claim belongs in a federal court.

Rep. No. 709, 75th Cong., 1st Sess., p. 91; S. Rep. No. 1162, 75th Cong., 1st Sess., p.7 ("This section imposes appropriate jurisdiction upon the courts of the United States over cases arising under the act."). The absence of legislative history obviously cannot defeat the express and unambiguous terms of a legislative enactment. *See INS v. Cardoza-Fonseca*, 480 U.S. 421, 452-53 (1987) (Scalia, J., concurring) ("Judges interpret laws rather than reconstruct legislators' intentions. Where the language of the law is clear, we are not free to replace it with an un-enacted legislative intent."). If anything, Congress's silence in the legislative history confirms that "duties" and "liabilities" are words that are sufficiently clear on their face to require no further elaboration.

B. *Courts Have Recognized that* Pan American *Did Not Address the Exclusive Jurisdiction Provisions of the Federal Power and Natural Gas Acts in the Context of Claims Based on "Duties" or "Liabilities"*

As intended by Congress, FERC decides the overwhelming majority of legal questions involving the Federal Power and Natural Gas Acts through orders on assorted regulatory filings, subject to federal appellate review. Only occasionally do third parties (*i.e.*, not FERC) file complaints in trial courts that raise questions under these statutes. Of those cases, a majority likely satisfy federal question jurisdiction under § 1331 or diversity jurisdiction under § 1332. Nevertheless, on occasion a complaint is filed in state court that seeks "to enforce any liability or duty created" by the Federal Power or Natural Gas Act without necessarily satisfying the complex *Grable* test for federal question jurisdiction. Congress enacted the more expansive "exclusive jurisdiction" language in the Federal Power and Natural Gas Acts to ensure that such claims are litigated in the federal courts.

For example, in *California ex rel. Lockyer v. Dynegy, Inc.*, 375 F.3d 831 (9th Cir. 2004), the California attorney general filed a complaint in state court alleging that wholesale electricity suppliers violated California's unfair business practices law,[7]

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[7] After deciding the jurisdictional application of § 317 of the Federal Power Act, *Dynegy* also addressed whether the Federal Power Act preempted the state-law claims, a separate legal question not at issue here.

id. at 839, with respect to the ancillary services markets administered by the California Independent System Operator ("CAISO"), *id.* at 836, the entity that "manages the flow of electricity across the grid and balances supply and demand in real time." *Id.* at 835. Specifically, the state claimed "that the producers fraudulently sold energy on the spot market from *reserve* capacity that they had contracted to hold in reserve." *Id.* at 836. The CAISO-administered markets, including the requirements at issue here, were governed by its tariff, which was filed with and accepted by FERC pursuant to the Federal Power Act. *Id.* at 835. Recognizing that "tariffs are the 'equivalent of a federal regulation,'" *id.* at 839 (citations omitted), the Ninth Circuit determined that, because "[t]he state lawsuit turns, entirely, upon the defendant's compliance with a federal regulation" (*i.e.* the CAISO tariff), *id.* at 841, the federal court had exclusive jurisdiction over the case pursuant to § 317, even if federal jurisdiction was lacking under § 1331. *Id.* at 840-42. Consistent with the statutory language providing "exclusive jurisdiction" for "all ... actions at law brought to enforce any liability or duty created by" the Federal Power Act, the Ninth Circuit found that, "[a]bsent a violation of the FERC-filed tariff, no state law liability could survive." *Id.* at 841.

Similarly, in *PacifiCorp v. Northwest Pipeline GP*, 2010 WL 3199950 (D. Or. 2010), a natural gas pipeline shipper filed a complaint in state court alleging state-law claims for breach of contract and *res ipsa loquitur* negligence for damage caused to its natural gas-fired power plant due to lubricating oil allegedly introduced into the pipeline system. *Id.* at

*1. Both claims "refer to the gas quality standard contained in [the pipeline's] FERC-filed tariff." *Id.* at *4. Although the "claims rest in part on an allegation that [the pipeline] violated a federal regulation [*i.e.*, a FERC tariff] that does not itself give rise to a private cause of action," the district court found the claims "constitute garden variety state law claims with an embedded federal issue" not subject to federal jurisdiction under § 1331. *Id.* However, because "the plaintiff[']s contract and negligence causes of action turn on the meaning of provisions in the FERC-filed tariff"—namely, its gas quality requirements—the court found that the claims constituted a suit "brought to enforce a liability or duty." *Id.* at *6. Therefore, the complaint fell within the "exclusive jurisdiction" provision of § 24 of the Natural Gas Act.

Dynegy and *PacifiCorp* correctly gave meaning to the full statutory language of § 317 of the Federal Power Act and § 24 of the Natural Gas Act, properly recognizing that the plaintiffs' state-law claims were merely attempts to enforce liabilities and duties created by the Acts. Both opinions also appropriately distinguished the facts before them with those in *Pan American*. In *Dynegy*, for instance, the court appropriately recognized that the complaint in *Pan American* did not fall within the "exclusive jurisdiction" provision of then-§ 22 of the Natural Gas Act because the plaintiff did not assert a right under the Natural Gas Act. *Dynegy*, 375 F.3d at 842-43. In other words, the complaint did not constitute a suit in law "*brought* to enforce a liability or duty" under the Natural Gas Act. The court in *Dynegy* also accurately explained that this Court in

Pan American "gave only modest attention to whether the contract had been filed" with the FPC, "given that the alleged private contract at issue ... did not implicate the federal regulatory regime." *Dynegy*, 375 F.3d at 843 (citing *Pan American*, 366 U.S. at 663); *see also PacifiCorp*, 2010 WL 3199950 at *5 (citing *Pan American*, 366 U.S. at 663, for the proposition that "[a]n exclusive jurisdiction provision does not confer federal jurisdiction ... if the plaintiff's claims are not predicated on the federal government's exclusive regulatory regime"). By contrast, the Ninth Circuit added, the state's lawsuit "represented a naked attempt" to enforce "obligations directly and exclusively arising under regulations issued pursuant to the [Federal Power Act]." *Dynegy*, 375 F.3d at 843.

Congress has plainly reposed exclusive jurisdiction in the federal courts over claims based on a duty or liability created by the Natural Gas or Federal Power Acts to promote the uniform interpretation of those statutes. Such claims far more closely resemble those asserted in *Manning* than in *Pan American*.[8] The Third Circuit in

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[8] Although sales of electricity and natural gas at wholesale continue to occur through bilateral contracts as in *Pan American*, those industries and their regulatory frameworks have evolved. For example, FERC's policies requiring open access for the jurisdictional transmission of electricity and natural gas have led to an increase in the number of customers taking such service. FERC-filed tariffs of generally applicability typically govern such service. As this Court has found, tariffs are not merely contracts; they bind the parties "with the force of law." *Lowden v. Simonds-Shields-Lonsdale Grain Co.*, 306 U.S. 516, 520 (1939) (discussing railroad tariffs issued pursuant to the Interstate Commerce Act, the predecessor to the Federal Power and Natural Gas Acts). A

Manning erred by concluding that *Pan American* controlled the outcome in this case because, unlike here, the plaintiff in *Pan American* did not assert any breach of a statutory or regulatory duty or liability. By contrast, claims expressly based on regulations promulgated by or tariffs filed with FERC under the Federal Power and Natural Gas Acts, as in *Dynegy* and *PacifiCorp*, present an entirely different set of concerns regarding the uniform interpretation of those Acts. It is to ensure the uniform interpretation and application of the Natural Gas Act and Federal Power Act that Congress conferred exclusive jurisdiction in the

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complaint brought to enforce duties or liabilities created by a tariff-based rate schedule raises issues well beyond those typically in a bilaterally-negotiated, two-party contract. For the transmission of electricity, in fact, FERC has created a *pro forma* Open Access Transmission Tariff adopted in near-identical form by most transmission providers.

FERC also has developed standardized tariff language for market-based rate tariffs governing the sale of electricity at wholesale, whose uniform interpretation in a federal forum is key. The same is true of the detailed rules governing organized markets for a variety of electricity products, particularly where those markets span multiple states. PJM Interconnection, L.L.C., for example, administers organized markets in all or part of 13 states and the District of Columbia, while the Midcontinent Independent System Operator, Inc.'s markets span 15 states and one Canadian province. *See* PJM Interconnection, L.L.C., *Who We Are*, *available at* http://www.pjm.com/about-pjm/who-we-are.aspx; Midcontinent Independent System Operator, Inc., Corporate Information, *available at* https://www.misoenergy.org/Library/Repository/Communication%20Material/Corporate/Corporate%20Fact%20Sheet.pdf. Maintaining exclusive federal jurisdiction over the interpretation of the market rules set forth in these tariffs, as intended by § 317 of the Federal Power Act, is essential.

federal courts over claims premised on the breach of a FERC regulation or a FERC-approved tariff. By using substantially similar language, the Exchange Act achieved the same objective with respect to the claims here based on SEC Regulation SHO.

CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals should be reversed.

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September 10, 2015

SUPREME COURT, U.S.
FILED
SEP 10 2015
OFFICE OF THE CLERK

No. 14-1132

In the Supreme Court of the United States

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.; KNIGHT CAPITAL AMERICAS L.P., FORMERLY KNOWN AS KNIGHT EQUITY MARKETS L.P.; UBS SECURITIES LLC; E*TRADE CAPITAL MARKETS LLC; NATIONAL FINANCIAL SERVICES LLC; AND CITADEL DERIVATIVES GROUP LLC, PETITIONERS

v.

GREG MANNING; CLAES ARNUP; POSILJONEN AB; POSILJONEN AS, SVEABORG HANDEL AS; FLYGEXPO AB; AND LONDRINA HOLDING LTD.,

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA AS *AMICUS CURIAE* SUPPORTING PETITIONERS

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INTEREST OF *AMICUS CURIAE*[1]

The Interstate Natural Gas Association of America ("INGAA") is a trade association that advocates regulatory and legislative positions of importance to the interstate natural gas pipeline industry in North America. INGAA represents the vast majority of interstate natural gas transportation pipeline companies operating in the United States, as well as comparable companies in Canada. Its members transport much of the nation's natural gas through a network of 200,000 miles of pipelines and also operate many interstate natural gas storage facilities. INGAA's members are regulated by the Federal Energy Regulatory Commission (FERC) under the Natural Gas Act. INGAA and its individual members have a substantial interest in contract stability, rate certainty, continued investment in energy infrastructure, and ensuring predictable, consistent, rational, and fair law and policy affecting natural gas transportation. To advance those interests, INGAA regularly participates as an *amicus* in cases concerning the proper regulation of the industry. See, e.g., *Morgan Stanley Capital Grp., Inc. v. Pub. Util. Dist. No. 1 of Snohomish Cnty., Wash.*, 554 U.S. 527 (2008).[2]

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[1] No counsel for a party has authored this brief in whole or part, and no person or entity other than *amicus* or its counsel made any monetary contribution intended to fund the preparation or submission of this brief. A blanket consent letter on behalf of all parties is on file with the Court.

[2] This brief represents the position of INGAA but not necessarily the views of any particular member with respect to any issue.

SUMMARY OF ARGUMENT

The decision of the court of appeals in this matter hinges, in part, on construction of the exclusive jurisdiction provision of the Securities Exchange Act (Section 27) and on this Court's holding in *Pan American Petroleum Corp. v. Superior Court of Delaware in and for New Castle County*, 366 U.S. 656 (1961), in which the Court discussed the substantially identical exclusive jurisdiction provision of the Natural Gas Act.[3] As a representative of the vast majority of interstate natural gas transporters operating in the United States, INGAA has a significant interest in this Court's construction of the Natural Gas Act and comparable language in the Securities Exchange Act.

To the extent the Court addresses whether Section 27 of the Securities Exchange Act creates an independent basis for federal jurisdiction, INGAA urges the Court to hold that it does. Claims to enforce rights or duties created by the Natural Gas Act or rules and regulations thereunder, including FERC orders and FERC-approved tariffs, are subject to the Natural Gas Act's exclusive jurisdiction provision and must be brought in federal court, regardless of whether they would otherwise withstand "arising under" scrutiny.[4]

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[3] At the time *Pan American* was decided, this provision was Section 22 of the Natural Gas Act; it is now Section 24.

[4] For the sake of brevity, and to avoid repetition, the term "FERC-approved tariffs" when used by itself includes tariffs in the strict sense, as well as other orders and directives issued by FERC.

The Natural Gas Act is a comprehensive, nationwide regulatory scheme governing interstate gas transportation. Within that scheme, interstate gas pipelines must file and abide by tariffs that are approved by FERC. These tariffs carry the weight of federal regulation and federal law. Crucial to the effectiveness of this comprehensive scheme—and the tariffs promulgated thereunder—is the concept of predictable and uniform enforcement and interpretation of tariffs and orders by the federal courts.

This notion is codified in Section 24 of the Natural Gas Act, which states federal courts "shall have exclusive jurisdiction" over both (a) all violations of the Natural Gas Act and the "rules, regulations and orders" under the Act, and (b) "all suits" and "actions" brought to "enforce any liability or duty" created by the Natural Gas Act and "any rule, regulation or order thereunder." 15 U.S.C. § 717u. Congress, therefore, unambiguously provided for exclusive federal jurisdiction in this small class of cases and claims.

In holding Section 27 of the Securities Exchange Act does not constitute a grant of jurisdiction, the court of appeals primarily relies on its interpretation of this Court's holding in *Pan American*, which discussed what is now Section 24 of the Natural Gas Act. The court of appeals' analysis, however, is flawed. In *Pan American*, the Court did not specifically address the types of claims that do enjoy exclusive federal jurisdiction under Section 24 of the Natural Gas Act. Rather, the Court simply found the claims asserted in that case did not fit within that

class and that anticipated defenses did not affect the well-pleaded complaint.

By the plain language of Section 24, Congress envisioned a narrow set of cases and claims exclusively within the expertise of the federal courts. These include claims nominally asserted under state law when they involve orders issued by FERC, alleged violations of the Natural Gas Act or FERC-approved tariffs, or duties and liabilities arising from the Natural Gas Act and FERC-approved tariffs. To hold otherwise renders Section 24 meaningless.

Contrary to the court of appeals' interpretation, *Pan American* does not hold Section 24 never confers jurisdiction. The facts and claims involved in *Pan American* simply did not implicate the violation or enforcement of the Natural Gas Act, a FERC-approved tariff, or any other "duty," "liability," "rule," or "regulation" under the Natural Gas Act. As such, to the extent the Court addresses its holding in *Pan American*, INGAA urges it to confirm federal courts have exclusive jurisdiction to hear all claims involving the enforcement of rights and duties arising under the Natural Gas Act and FERC-approved tariffs.

Further, *Pan American* did not address the precise question presented in this case—whether an exclusive jurisdiction provision confers exclusive jurisdiction when the claims alleged necessarily involve enforcement of "duties" or "liabilities" created by the federal statutory scheme or the regulations promulgated thereunder. In order to provide the predictability and certainty that Congress intended

for a nationwide scheme, such claims must be brought in federal court. In particular, claims by and against interstate pipelines that fit within this class must be brought and heard in federal court and not state court.

ARGUMENT

I. Congress enacted the Natural Gas Act to provide a comprehensive, nationwide regulatory scheme for the transportation of natural gas.

The Natural Gas Act, 15 U.S.C. §§ 717–717z, establishes a "comprehensive scheme of federal regulation" that vests the FERC with "exclusive jurisdiction over the transportation . . . of natural gas in interstate commerce for resale." *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293, 300–01 (1988). Interstate gas pipelines, therefore, are subject to the Natural Gas Act and are regulated by FERC.[5]

Congress enacted the Natural Gas Act in 1938 in order to assert federal control over interstate natural gas transmission. Gas transportation had become an increasingly interstate industry and, as the volume of gas sold and transported along interstate pipelines increased in the United States, Congress regarded state regulations as ineffective. See *Panhandle E. Pipe Line Co. v. Pub. Serv.*

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[5] Section 1(b) of the Natural Gas Act extends federal jurisdiction over interstate transportation of natural gas, as well as the companies engaged in such transportation. 15 U.S.C. § 717(b).

Comm'n of Ind., 332 U.S. 507, 515 (1947). The Natural Gas Act was a response to demand for federal regulation and for Congress to curb the market power of interstate pipelines. *Id.* at 516. The Natural Gas Act was intended to provide necessary uniformity and predictability through national regulation of interstate gas transportation. See, e.g., 15 U.S.C. § 717(a) ("Federal regulation in matters relating to the transportation of natural gas . . . in interstate and foreign commerce is necessary in the public interest."). Congress intended to create a "comprehensive and effective regulatory scheme" over interstate gas transportation. *Panhandle*, 332 U.S. at 520; *accord Atl. Ref. Co. v. Pub. Serv. Comm'n of N.Y.*, 360 U.S. 378, 388 (1959). The scheme removed interstate transportation from state regulation, substituting a federal regulatory regime in its place.

FERC is the agency charged with the administration of the Natural Gas Act, and its jurisdiction is laid out in § 1(b). FERC has jurisdiction over matters relating to the transportation of natural gas in interstate commerce. *Schneidewind*, 485 U.S. at 295, 301, 305. Where Congress has granted FERC jurisdiction, "that jurisdiction is exclusive." *In re Cal. Wholesale Elec. Antitrust Litig.*, 244 F. Supp. 2d 1072, 1076 (S.D. Cal. 2003); *accord Miss. Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354, 377 (1988) (Scalia, J., concurring) ("[I]t is common ground that if FERC has jurisdiction over a subject, the States cannot have jurisdiction over the same subject."). Sections 4 and 5 of the Natural Gas Act govern FERC's superintendence of rates for interstate gas

transmission. Section 5 empowers FERC with oversight over "any rule, regulation, practice or contract affecting" the rates charged for interstate transportation. 15 U.S.C. § 717(d).

States, therefore, cannot regulate the rates charged by interstate gas transporters; this is the domain of FERC. Further, pursuant to the Natural Gas Act, interstate transporters must file and adhere to tariffs, which must be approved by FERC.

As time passed, pipelines shifted away from bundled services with the FERC's encouragement. In 1992, FERC Order No. 636 required such unbundling. The interstate gas pipelines are now required to provide open and equal access to all shippers. The importance of a uniform and consistent body of law has become apparent as this regulatory regime developed. In particular, a consistent body of law regarding enforcement of orders, "duties," and "liabilities" under the Natural Gas Act and FERC-approved tariffs is crucial.

A. The regulatory framework for interstate gas transportation is driven by FERC-approved tariffs, which carry the force of federal law.

Under § 4 of the Natural Gas Act, interstate gas pipelines must file with FERC all rates and any changes they propose in their rates. The rates a regulated gas company files with FERC are lawful only if they are "just and reasonable." 15 U.S.C. § 717c(a); see also *Ark. La. Gas v. Hall*, 453 U.S. 571, 577 (1981).

The filed tariff is the seminal document that controls the rates charged and services provided by interstate gas pipelines.[6] An interstate gas pipeline's rate schedules, together with the forms it uses for its service agreements with customers, constitute its tariff. 18 C.F.R. § 154.3. No pipeline may charge its customers more than the rates FERC has permitted to take effect and that appear in the tariff. *Id.* § 154.3(a). A typical tariff also contains "general terms and conditions" that include provisions governing gas quality, terms for billing and payment, and other matters related to transportation.

A filed tariff is the equivalent of a federal regulation and, therefore, is federal law. *Lowden v. Simonds-Shields-Lonsdale Grain Co.*, 306 U.S. 516, 520 (1939).[7] As such, there is a need for uniform and consistent enforcement of the duties and liabilities arising from and through FERC-approved tariffs.

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[6] See, e.g., Gas Transmission Northwest Corporation's Third Revised Volume No. 1-A tariff, on file and publicly available through FERC's online database: https://www.ferc.gov/industries/gas/gen-info/fastr/htmlall/014333_000100/014333_000100__contents.htm.

[7] Various circuit courts uniformly recognize this concept. See *Bryan v. BellSouth Commc'ns, Inc.*, 377 F.3d 424, 429 (4th Cir. 2004), *cert. denied*, 543 U.S. 1187 (2005); *Cahnmann v. Sprint Corp.*, 133 F.3d 484, 488 (7th Cir. 1998); *W. Union Int'l, Inc. v. Data Dev., Inc.*, 41 F.3d 1494, 1496 (11th Cir. 1995); *MCI Telecomms. Corp. v. Garden State Inv. Corp.*, 981 F.2d 385, 387 (8th Cir. 1992); *Carter v. AT&T Co.*, 365 F.2d 486, 496 (5th Cir. 1966).

B. The Natural Gas Act provides for exclusive jurisdiction in federal courts of claims involving rights and duties under the Natural Gas Act, FERC orders, and FERC-approved tariffs.

Given that interstate gas transportation is federally regulated, it is not surprising that Congress provided for exclusive federal jurisdiction in that class of cases in which violations of the Natural Gas Act, FERC orders and FERC-approved tariffs are alleged, as well as "all suits in equity and actions at law" to enforce any "liability or duty" arising from any rule, regulation, or order under the Natural Gas Act. Again, FERC-approved tariffs are federal regulations promulgated pursuant to the Natural Gas Act.

Section 24 of the Natural Gas Act provides, in relevant part:

> "District Courts of the United States . . . ***shall have exclusive jurisdiction*** of violations of this chapter or the rules, regulations, and orders thereunder, and of ***all suits in equity and actions at law brought to enforce any liability or duty*** created by, or to enjoin any violation of, this chapter ***or any rule, regulation, or order thereunder***."

15 U.S.C. § 717u (emphases added).

The language Congress used in Section 24 is clear and unambiguous, providing exclusive federal

jurisdiction in the small sub-class of claims and suits in which violations or enforcement of FERC orders or FERC-approved tariffs are implicated.[8] Where the will of Congress is expressed in reasonably plain terms, "that language must ordinarily be regarded as conclusive." *Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980). Because there is a limited set of claims that would fit within Section 24, there is no need to complicate the analysis with the court of appeals' multi-faceted approach.

II. Section 24 expresses Congress' intent that only federal courts hear claims asserting violations of the Natural Gas Act and claims to enforce "liabilities" or "duties" under the Natural Gas Act, FERC orders, and FERC-approved tariffs.

FERC-issued orders and FERC-approved tariffs undeniably are issued pursuant to the Natural Gas Act. Under Section 24's plain language, therefore, any order issued by FERC and any FERC-approved tariff necessarily is included in the phrases "orders thereunder" and "rule, regulation, or order thereunder." Thus, any suit alleging a "violation of" any such order or tariff, as well as any suit to enforce a liability or duty under an order or tariff, is subject to exclusive jurisdiction in the federal courts. *Lynch*

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[8] Unlike other state law claims that may tangentially touch upon federal law, these claims directly implicate federal law. This is a necessarily limited group of claims and cases; therefore concerns over inundation of the federal courts are not applicable.

v. Alworth-Stephens Co., 267 U.S. 364, 370 (1925) ("The plain, obvious, and rational meaning of a statute is always to be preferred . . . ."); *Pensacola Tel. Co. v. W. Union Tel. Co.*, 96 U.S. 1, 12 (1878) (holding the Court must presume lawmakers use words in "their natural and ordinary significance"). The term "regulation" used in Section 24 also undisputedly includes FERC-approved tariffs, since they carry the weight of both federal regulation and federal law.

This centralization of claims in the federal courts is critical to the national, uniform enforcement of duties and liabilities under the Natural Gas Act and, in particular, the uniform enforcement and interpretation of FERC orders and FERC-approved tariffs. This is the only reasonable interpretation of Section 24. A nationwide regulatory scheme must rely on a consistent body of federal case law enforcing the liabilities and duties created by FERC-approved tariffs. As Congress has noted, this serves the public interest.[9]

Therefore, even claims nominally asserted under state law must be filed in federal court when they implicate or require enforcement of liabilities and duties created under FERC-approved tariffs.

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[9] "Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary and in the public interest." Natural Gas Act of 1937, § 1, H.R. 6586, 75th Cong. (3d Sess. 1938).

III. Section 24 should be read to grant exclusive jurisdiction in this limited set of cases and claims, as held by the Ninth Circuit.

The Court should endorse the Ninth Circuit's interpretation that exclusive jurisdiction provisions present a special category of cases and claims for exclusive federal jurisdiction. Such provisions clearly evidence Congress' intent that the federal courts have exclusive jurisdiction to resolve claims to enforce any right or obligation created by Congress in enacting a comprehensive scheme of federal regulation, such as the Natural Gas Act. While they do not create a federal cause of action, they do confer original jurisdiction upon the federal courts to hear these types of claims.

However, even if the Court determines federal courts still must perform an "arising under" analysis for such claims, INGAA urges the Court to hold that exclusive jurisdiction provisions like Section 24 broaden the scope of what constitutes "arising under" in claims to enforce rights or duties under the Natural Gas Act and FERC-approved tariffs. To continue to subject these claims to the non-industry-specific "arising under" analysis would thwart Congress' clearly expressed intent that this class of claims be resolved exclusively by the federal courts.

A. The Ninth Circuit view: Exclusive jurisdiction provisions create a special category of cases and claims because Congress carved out certain claims for federal courts' determination.

The Ninth Circuit held exclusive jurisdiction provisions like Section 24 present a special category of cases for exclusive federal jurisdiction. *California ex rel. Lockyer v. Dynegy, Inc.*, 375 F.3d 831, 842 (9th Cir. 2004).

First, in *Sparta Surgical Corp. v. National Association of Securities Dealers*, the court held Section 27 of the Securities Exchange Act of 1934 vests exclusive jurisdiction in the federal courts to hear claims alleging violations of the rules and regulations thereunder, reasoning "[t]he rule that state law claims cannot be alchemized into federal causes of action by incidental reference . . . has no application when relief is partially predicated on a subject matter committed exclusively to federal jurisdiction." 159 F.3d 1209, 1212–13 (9th Cir. 1998).

Then, in *Dynegy*, the court held claims "to enforce obligations that squarely fall within the exclusive jurisdiction provision of the Federal Power Act" do not require the general federal question analysis. 375 F.3d at 841–43. The court explained that although California asserted claims under its own unfair competition laws, "[t]he state lawsuit turns, entirely, upon the defendant's compliance with a federal regulation," specifically, the filed tariff promulgated under the Federal Power Act. *Id.* at 841

("Absent a violation of the FERC-filed tariff, no state law liability could survive."). Because Section 317 of the Federal Power Act confers upon the federal courts exclusive jurisdiction to hear claims to enforce any liability or duty created thereunder, California's action to enforce obligations created by the tariff could be resolved only in the federal court.[10]

Only the Third Circuit, in the underlying opinion, has expressly disagreed. The Sixth Circuit's opinion in *Columbia Gas Transmission, LLC v. Singh*, 707 F.3d 583 (6th Cir. 2013), for instance, is not irreconcilable. In *Singh*, a gas pipeline company sued property owners to enjoin them from engaging in activity with respect to existing real property easements. Reversing the district court's finding of jurisdiction, the court of appeals held the pipeline's claim did not arise under the Natural Gas Act because the pipeline did not allege the Act imposed any duty on the property owners or that the property owners violated any provision of the Act or rules or regulations thereunder. *Id.* at 588. In other words, the claim did not seek to enforce rights or obligations created by the Natural Gas Act or a FERC-approved tariff and, therefore, did not trigger the Act's exclusive jurisdiction provision in the first place.

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[10] Following this logic, at least one district court held breach of contract and negligence claims that relied upon gas quality provisions from an interstate pipeline's filed tariff fell within the exclusive jurisdiction statute. *See PacifiCorp v. Northwest Pipeline GP*, No. CV. 10-99-PK, 2010 WL 3199950, at *6 (D. Or. June 23, 2010) ("[T]he plaintiff's contract and negligence causes of action turn on the meaning of provisions in the FERC-filed tariff . . . .").

Singh, however, incorrectly interpreted this Court's opinion in *Pan American* as requiring the district court to perform an "arising under" analysis before determining whether Section 24 creates exclusive jurisdiction: "In [*Pan American*] the Supreme Court clarified that § [24] does not create jurisdiction beyond standard federal 'arising under' jurisdiction. As Justice Frankfurter stated, '[e]xclusiveness is a consequence of having jurisdiction, not the generator of jurisdiction because of which state courts are excluded.'" *Id.* at 591 (quoting *Pan American*, 366 U.S. at 664). *Pan American*, which pre-dated *Merrell Dow* and *Grable & Sons Metal Products, Inc. v. Darue Engineering & Manufacturing*, 545 U.S. 308 (2005), does not require an "arising under" analysis for claims to enforce rights or duties created by the Natural Gas Act and FERC-approved tariffs, but rather merely reiterates that the well-pleaded complaint rule applies universally.

B. Pan American: the well-pleaded complaint must articulate a claim to enforce rights or duties created by the Natural Gas Act or a FERC-approved tariff.

The claim at issue in this Court's opinion in *Pan American* did not implicate the Natural Gas Act or any rules or regulations thereunder. Rather, the claim at issue involved breach of a private agreement between a gas pipeline company (Cities Services) and a producer of natural gas (Pan American). *Pan Am.*, 366 U.S. at 658.

The parties' gas purchase contract had a fixed price, but the Kansas Corporation Commission subsequently promulgated an order fixing a minimum price higher than the rate set forth in the contract. *Id.* Cities Services advised Pan American by letter that to avoid penalties, it would pay the higher rate while it contested the validity of the Kansas order, but that it preserved its rights to seek recovery of the difference between the contract price and the amount paid, and that it expected Pan American to refund the overpayment if the order was invalidated. *Id.* at 658–59. Each payment check Cities Services sent to Pan American had a notation stating the payment was subject to the reservations set forth in the letter. *Id.* at 659. Pan American responded that it would accept the payments subject to Cities Services' demand for a refund for overpayment if the minimum-rate order was invalidated. *Id.* When the Court subsequently determined the Kansas Corporation Commission's minimum-rate order was invalid, Pan American refused to refund the overpayments, and Cities Services sued in the state court for Pan American's breach of the agreement to refund the overpayment, not for breach of any obligation under the Natural Gas Act or Pan American's tariff. *Id.* at 660–61.

Like *Singh*, therefore, *Pan American* did not involve a claim to enforce rights or obligations created by the Natural Gas Act or Cities Services' FERC-approved tariff. The Court noted it was "not called upon to decide the extent to which the Natural Gas Act reinforces or abrogates the private rights here in controversy," since the claim did not assert a

violation of the Act or a tariff. *Id.* at 664. Rather, the fact that Cities Services sued to enforce its side agreement with Pan American was decisive. *Id.* Accordingly, the Court held it did not appear on the face of the complaint that the claim depended upon determination of a question of federal law. *Id.* at 663.[11]

The Court further held the Natural Gas Act's exclusive jurisdiction provision would not make a non-federal claim federal, stating: "Exclusiveness is a consequence of having jurisdiction, not the generator of jurisdiction . . . ." *Id.* at 664. The Court noted this rule "was settled long ago" in *Pratt v. Paris Gaslight & Coke Co.*, 168 U.S. 255 (1897), in which the Court found federal jurisdiction lacking because the invalidity of certain patents arose only in defense to the complaint asserting common law breach of contract. In that opinion, the Court held, as quoted in *Pan American*, "There is a clear distinction between a case and a question arising under the patent laws. The former arises when the plaintiff in his opening pleading . . . sets up a right under the patent laws as ground for a recovery. Of such the state courts have no jurisdiction." *Id.* at 259.

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[11] The Court cited *Skelly Oil Co. v. Phillips Petroleum Co.*, 339 U.S. 667 (1950), another case in which state law claims did not implicate any violation or enforcement of the Natural Gas Act, a FERC order or a FERC-approved tariff. In *Skelly Oil*, the contract underlying the breach of contract claim was a collateral contract that did not incorporate or implicate the terms of a FERC-approved tariff. *Id.* at 669.

Thus, in both *Pan American* and *Pratt*, the Court focused on whether the well-pleaded complaints alleged claims to enforce rights or obligations created by a comprehensive federal regulatory scheme, not on whether the claims met the as-yet unarticulated *Merrell Dow* and *Grable & Sons* "arising under" test. This test is too broad to give effect to Congress' clearly stated intent that federal courts exclusively resolve claims to enforce rights and obligations created by the Natural Gas Act and FERC-approved tariffs. In light of Section 24, a state court cannot be called upon to resolve matters Congress intended to exclude from the states' jurisdiction.

CONCLUSION

For the foregoing reasons, the decision by the Third Circuit below should be reversed.

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September 10, 2015

Supreme Court, U.S.
FILED
OCT 23 2015
OFFICE OF THE CLERK

No. 14-1132

In the Supreme Court of the United States

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.; KNIGHT CAPITAL AMERICAS L.P., FORMERLY KNOWN AS KNIGHT EQUITY MARKETS L.P.; UBS SECURITIES LLC; E*TRADE CAPITAL MARKETS LLC; NATIONAL FINANCIAL SERVICES LLC; AND CITADEL DERIVATIVES GROUP LLC,
Petitioners,

v.

GREG MANNING; CLAES ARNRUP; POSILJONEN AB; POSILJONEN AS; SVEABORG HANDEL AS; FLYGEXPO AB; AND LONDRINA HOLDING LTD.,
Respondents.

On Writ of Certiorari to the
United States Court of Appeals for the Third Circuit

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QUESTION PRESENTED

Section 27 of the Securities Exchange Act of 1934 (Exchange Act) provides that federal courts "shall have exclusive jurisdiction" over "violations of [the Exchange Act] or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by [the Exchange Act] or the rules and regulations thereunder." 15 U.S.C. § 78aa(a).

In this case, Respondents filed suit under state law in New Jersey state court seeking to enforce liabilities and duties created by New Jersey law, not the Exchange Act or its regulations. It is undisputed that not a single claim raised in this suit *necessarily* turns on federal law, but Petitioners maintain that at least one claim *might possibly* turn on an Exchange Act regulation, a contention the court of appeals rejected and Respondents dispute.

The question presented is:

Whether Section 27 of the Exchange Act strips away traditional state-court jurisdiction over state-law claims whenever there is a *mere possibility* that an issue related to the Exchange Act might resolve one element of a single claim.

RULE 29.6 STATEMENT

Posiljonen AB has no parent corporation, and no publicly held corporation owns 10% or more of Posiljonen AB's stock.

Posiljonen AS has no parent corporation, and no publicly held corporation owns 10% or more of Posiljonen AS's stock.

Sveaborg Handel AS has no parent corporation, and no publicly held corporation owns 10% or more of Sveaborg Handel AS's stock.

Flygexpo AB has no parent corporation, and no publicly held corporation owns 10% or more of Flygexpo AB's stock.

Londrina Holding Ltd. has no parent corporation, and no publicly held corporation owns 10% or more of Londrina Holding Ltd.'s stock.

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INTRODUCTION

This dispute involves a classic case of market manipulation. Respondents were investors in Escala Group, Inc. ("Escala"). They sued Petitioners, a group of major financial institutions, in New Jersey state court asserting a series of New Jersey state-law claims. In each of those state-law claims, Respondents alleged that Petitioners caused their investment in Escala to decline substantially through a pattern of manipulative "naked short-selling."

"'Short-selling' is the practice of borrowing shares of stock, selling them and seeking to repurchase those shares at a lower price, returning the lower-priced shares to the lender and keeping the difference as profit." *Fairfax Fin. Holdings. Ltd. v. S.A.C. Capital Mgmt., LLC*, Civ. No. 06-4197, 2007 WL 1456204, at *1 (D.N.J. May 15, 2007).

"'Naked short-selling' occurs when traders sell shares they do not own or borrow, or ever intend to own, and never deliver the 'borrowed' securities that they sell." Report and Recommendation, ECF No. 36, at 2-3 (citing *Avenius v. Banc of Am. Sec. LLC*, Civ. No. 06-4458, 2006 WL 4008711, at *1 (N.D. Cal. Dec. 30, 2006); *Capece v. DTCC*, Civ. No. 05-80498, 2005 WL 4050118, at *3 (S.D. Fla. Oct. 11, 2005)).

Manipulative naked short-selling can artificially depress a stock's price at the expense of innocent investors and the gain of abusive brokers and traders. That is what Respondents allege occurred here—Petitioners did not merely fail to follow the fine print of some technical regulation; they engaged in pure and simple manipulative and deceptive practices, exactly the

kind of behavior that has been long prohibited under New Jersey common law and statutes.

New Jersey is not alone. The common and statutory law of numerous states similarly forbids Petitioners' conduct, and the Securities Exchange Act of 1934 ("Exchange Act") and its implementing regulations likewise target this financial misbehavior.

As is their right, Respondents chose to seek a remedy for Petitioners' misconduct *exclusively* under New Jersey law. Every claim asserted by Respondents is a New Jersey claim seeking to remedy violations of New Jersey law. And as the court of appeals expressly held, none turns in any way on federal law: "As we read the Amended Complaint, no causes of action are predicated *at all* on a violation of [federal law]." Pet. App. 14a (emphasis in original). Were the entirety of the Exchange Act and its regulations repealed tomorrow, not a single claim in Respondents' complaint would be threatened.

Undaunted, Petitioners claim Section 27 of the Exchange Act confers exclusive jurisdiction in these circumstances, stripping New Jersey state courts of the ability to determine whether Petitioners violated New Jersey state law. Not so.

Petitioners misread the text of the Exchange Act to suggest a radical jurisdictional theory that is simultaneously unfaithful to Congressional intent, this Court's jurisdictional teachings, and common sense.

Affirmance is warranted.

STATEMENT

A. Statutory Background

1. States have long made it illegal to manipulate the securities markets. *See generally* James Burk, *Values in the Marketplace: The American Stock Market Under Federal Securities Law* 169 (1988) (Table: C.2: Major Actions by Various States to Regulate Securities Business, 1852-1921) (describing state efforts); Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 Tex. L. Rev. 347, 352-64 (1991) (discussing impetus behind state "blue sky laws"); Louis Loss & Edward M. Cowett, *Blue Sky Law* 7-8 (1958) (asserting that blue sky laws grew out of awareness of "the many instances in which unsophisticated ... investors had been bilked of their life savings by sellers of worthless or fraudulent securities").

By the time Congress passed the first federal securities laws, every state but Nevada had enacted its own. Joel Seligman, *The Transformation of Wall Street* 45 (rev. ed. 1995). Many of these state statutes had prohibitions on fraud and misrepresentation.[1] And the state regulatory infrastructures were generally well-

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[1] *See, e.g.*, Br. in Opp. 1 n.1 (collecting statutes). These statutes survived numerous constitutional challenges because they were deemed legitimate exercises of the states' police power. As this Court confirmed in upholding one statute:

> [W]e think the statute under review is within the power of the state. It burdens honest business, it is true, but burdens it only that, under its forms, dishonest business may not be done.

Merrick v. N.W. Halsey & Co., 242 U.S. 568, 587 (1917). *See also Hall v. Geiger-Jones Co.*, 242 U.S. 539, 551 (1917) ("[W]e shall not pause to do more than state that the prevention of deception is within the competency of government ....").

developed. *See* Larry D. Soderquist, *Understanding the Securities Laws* 16 (2d ed. 1990) (noting exclusive securities regulation by states until 1933).

2. It was against this backdrop of established state regulation that Congress passed the Securities Act of 1933, 15 U.S.C. § 77a *et seq.* ("Securities Act"), and the Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq.* ("Exchange Act"). Drafters of the federal Acts relied heavily on existing state statutes for guidance. *See* 1 Louis Loss & Joel Seligman, *Securities Regulation* 180 (1989) (antifraud provisions drawn from New York's Martin Act).[2] In enacting federal legislation, they hoped to make it more difficult for prospective fraudsters to elude regulation through state loopholes or by crossing state lines. *See generally* Michael A. Perino, *Fraud and Federalism: Preempting Private State Securities Fraud Causes of Action*, 50 Stan. L. Rev. 273, 280-82 (1998) (explaining impetus to improve deterrence and enforcement).

Both Acts largely preserved and supplemented existing state authority over the securities markets. They explicitly provided that "the rights and remedies provided by this subchapter shall be *in addition to* any and all other rights and remedies that may exist at law or in equity." Securities Act of 1933, Pub. L. No. 73-22, ch. 38, § 16, 48 Stat. 74, 84 (1933); Securities Exchange Act of 1934, Pub. L. No. 73-291, ch. 404, § 28, 48 Stat.

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[2] *See also* Raymond Moley, *After Seven Years* 180 (1939) (drafter Benjamin Cohen said to have "considerable experience in the drafting of state [securities] laws"); James M. Landis, *The Legislative History of the Securities Act of 1933*, 28 Geo. Wash. L. Rev. 29, 33 (1959) (drafter James Landis had spent several years studying state blue sky laws).

881, 903 (1934) (emphasis added). And the Securities Act included a removal bar that permitted plaintiffs to litigate their claims in state court regardless of the defendants' forum preference. 15 U.S.C. § 77v(a).

Indeed, the available legislative history makes clear that Congress specifically intended an ongoing role for the states in securities regulation. *See Hearings on S. Res. 84, S. Res. 56 & S. Res. 97 Before the S. Comm. on Banking and Currency*, 73d Cong. 6577 (1934) (statement of Thomas Corcoran, principal Exchange Act draftsman, regarding intention to leave states as much leeway as possible to regulate securities transactions); *Leroy v. Great W. United Corp.*, 443 U.S. 173, 182 n.13 (1979) (legislative history of Exchange Act indicated intent to leave states significant authority).[3]

The Exchange Act did not include an express private right of action for defrauded purchasers or sellers of securities.[4] After its passage, defrauded securities investors continued to bring state lawsuits in state courts. *See, e.g., White v. Fin. Guarantee Corp.*, 56 P.2d 550, 551 (Cal. Ct. App. 1936) (securities fraud under California Corporate Securities Act); *Anderson v. Mikel Drilling Co.*, 102 N.W.2d 293, 297 (Minn. 1960) (securities fraud under Minnesota Securities Act);

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[3] *See also* Perino, *Fraud & Federalism*, at 281-82 (explaining that displacing state authority would have heightened already significant constitutional questions); Joel Seligman, *Remarks at University of Washington Securities Law Conference* (Mar. 1997) (asserting that Speaker Rayburn insisted on preservation of state securities regulation as condition of speedy passage).

[4] It *did* create a private right of action for market manipulation. *See* 15 U.S.C. § 78i.

Curtis v. State, 109 S.E.2d 868, 871 (Ga. Ct. App. 1959) (securities fraud under Georgia Securities Act).

3. Meaningful federal-securities litigation had to await a number of watershed developments, including: the Securities and Exchange Commission (SEC) promulgation of Rule 10b-5 (1942);[5] judicial recognition of a private right of action to enforce Rule 10b-5 (1946);[6] SEC support for private federal securities law enforcement (early 1960s);[7] and the liberalization of Rule 23 of the Federal Rules of Civil Procedure (1966).[8]

Following the advent of the modern federal class action device, the growing plaintiffs' securities class action bar largely ignored the state courts.[9] It remained

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[5] Exchange Act Release No. 34-3230 (May 21, 1942). Rule 10b-5 specifically prohibits fraud and misrepresentation in connection with the purchase or sale of any security. *See* 17 C.F.R. § 240.10b-5. It is the principal antifraud provision in the federal securities regime.

[6] *See Kardon v. Nat'l Gypsum Co.*, 69 F. Supp. 512, 514-15 (E.D. Pa. 1946).

[7] *See J.I. Case Co. v. Borak*, 377 U.S. 426, 427 (1964); *In re Cady, Roberts & Co.*, Exchange Act Release No. 6668, [1961-1964 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,803, at 81,013 (Nov. 8, 1961).

[8] *See* Arthur R. Miller, *Of Frankenstein Monsters and Shining Knights: Myth, Reality, and the "Class Action Problem"*, 92 Harv. L. Rev. 664, 665-68 (1979) (analyzing effect of the 1966 amendments).

[9] As one prominent practitioner told Congress, "State court class actions involving nationally traded securities were virtually unknown . . . ." *The Securities Litigation Uniform Standards Act of 1997 – S. 1260: Hearing before the Subcomm. on Sec. of the S. Comm. On Banking, Hous. & Urban Affairs*, 105th Cong. 70 (1998) (statement of John F. Olson, Gibson, Dunn & Crutcher LLP). *See generally* Perino, *Fraud and Federalism*, at 284-86 (explaining that federal class action litigation under Rule 10b-5 offers advantages

uncontroversial, however, that a victim of securities fraud or market manipulation could *choose* between bringing suit in state court for state law violations,[10] in federal court for Exchange Act violations, or in federal court for both state law and Exchange Act violations.[11]

4. By the mid-1990s, there was broad legislative consensus that federal securities class actions had evolved into a practice rife with abuse. *See Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 81 (2006) ("*Dabit*"). Congress enacted the Private Securities Litigation Reform Act of 1995 ("PSLRA") to curb these perceived abuses, in large part by imposing significant new procedural hurdles. H.R. Conf. Rep. No. 104-369, 31 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 730. But because these rules did not apply to state court litigation, the PSLRA had the "unintended consequence" of driving securities class actions to state courts. *Dabit*, 547 U.S. at 81-82; *see also* H.R. Rep. No. 105-640, at 10 (1998).

In response, Congress passed the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), which effectively abolished state law *class actions* concerning fraud or manipulation of the federally regulated securities market. *See* SLUSA, Pub. L. No. 105-353, §§ 2(2), (5), 112 Stat. 3227, 3227 (1998) (goal to

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over state actions, including easier class certification and greater potential damages from nationwide classes, and that many state laws limit securities actions in important ways).

[10] *See, e.g., Tucker v. Mariani*, 655 So. 2d 221, 224 (Fla. Dist. Ct. App. 1995) (securities fraud under Florida Statutes).

[11] *See, e.g., Gieringer v. Silverman*, 539 F. Supp. 498, 501 (E.D. Wis. 1982), *aff'd*, 731 F.2d 1272 (7th Cir. 1984) (Exchange Act and Wisconsin Securities Act claims).

"prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the [PSLRA]").

As this Court has explained, SLUSA did not "preempt" state law, but rather made "some state-law claims nonactionable through the class action device in federal as well as state court." *Kircher v. Putnam Funds Trust*, 547 U.S. 633, 636 n.1 (2006). In other words, Congress did not choose to preempt all state laws prohibiting fraud or market manipulation in connection with federally regulated securities, but only to preclude class action lawsuits asserting those claims. *Dabit*, 547 U.S. at 87 ("The [Exchange] Act does not deny any individual plaintiff, or indeed any group of fewer than 50 plaintiffs, the right to enforce any state-law cause of action that may exist.").

Consequently, the dual state-federal regulatory regime contemplated by the Depression-era Congress continues to this day.

B. Procedural History

Respondents are former shareholders of Escala, a New Jersey-based company whose market capitalization plummeted nearly $800 million in the short span of eleven months. Pls.' Reply, ECF No. 30, at 7 n.8; Pet. App. 45a-46a (AC ¶¶ 7-13). Petitioners are several large financial institutions who facilitated the manipulative naked short-selling of Escala common stock. Pet. App. 46a-47a (AC ¶¶ 14-20).

"'Short-selling' is the practice of borrowing shares of stock, selling them and seeking to repurchase those shares at a lower price, returning the lower-priced shares to the lender and keeping the difference as

profit." *Fairfax Fin. Holdings. Ltd. v. S.A.C. Capital Mgmt., LLC*, Civ. No. 06-4197, 2007 WL 1456204, at *1 (D.N.J. May 15, 2007).

"'Naked short-selling' occurs when traders sell shares they do not own or borrow, or ever intend to own, and never deliver the 'borrowed' securities that they sell." Report and Recommendation, ECF No. 36, at 2-3 (citing *Avenius v. Banc of Am. Sec. LLC*, Civ. No. 06-4458, 2006 WL 4008711, at *1 (N.D. Cal. Dec. 30, 2006); *Capece v. DTCC*, Civ. No. 05-80498, 2005 WL 4050118, at *3 (S.D. Fla. Oct. 11, 2005)). Naked short-selling can be a tool for market manipulation. This case is about whether Petitioners engaged in a pattern of manipulative naked short-selling in violation of New Jersey laws.

1. On May 8, 2012, Respondents sued Petitioners in the Superior Court of New Jersey, Law Division, Morris County. Pet. App. 26a. Plaintiff Gregory Manning, the owner of approximately 2.1 million shares of Escala stock during the relevant period, lives in Morris County, Pet. App. 45a (AC ¶ 7), which neighbors Escala's principal place of business, Essex County, Pet. App. 48a (AC ¶ 22). In an Amended Complaint, Respondents alleged two kinds of wrongdoing under New Jersey law:[12]

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[12] Specifically, the Amended Complaint asserts ten specific causes of action under New Jersey law: (1) violation of NJRICO § 2C:41-2(c), Pet. App. 82a-90a (AC ¶¶ 88-113); (2) violation of NJRICO § 2C:41-2(a), Pet. App. 91a-93a (AC ¶¶ 114-22); (3) unjust enrichment, Pet. App. 93a-94a (AC ¶¶ 123-27); (4) unlawful interference with prospective economic advantage, Pet. App. 94a-95a (AC ¶¶ 128-33); (5) tortious interference with contractual relations, Pet. App. 95a-97a (AC ¶¶ 134-40); (6) unlawful interference with contractual relations, Pet. App. 97a-98a (AC ¶¶ 141-45); (7) third party beneficiary claims, Pet. App. 98a-99a (AC ¶¶

First, they alleged that Petitioners—in their capacity as securities brokers—intentionally gave false "locates" to customers who wanted to short Escala stock. *See, e.g.*, Pet. App. 58a (AC ¶ 41) ("Defendants were saying they had Escala securities available to lend to facilitate additional short selling *at the same time* they did not have sufficient Escala securities to cover past sales.") (emphasis added); Pet. App. 58a (AC ¶ 42) ("Defendants claimed to receive Locates from other Defendants (or non-party banks) on dates when those other Defendants (or non-party banks) did not have sufficient Escala securities to cover the alleged Locates and accepted Locates they knew were unreliable."); Pet. App. 74a (AC ¶ 79a) ("[Defendants] created false documentation of their . . . loaning and ownership in Escala shares.").

According to the Amended Complaint, Defendants' motive was simple: to reap massive commissions for doing nothing. Pet. App. 88a (AC ¶ 106) ("Defendants charged short sellers fees for these sham 'loans' of stock."). By permitting their customers to short more stock than actually existed in a small, thinly-traded company, Defendants depressed Plaintiffs' share value to collect bogus commissions for themselves. Pet. App. 56a (AC ¶ 37a) (alleging harm through "creating and/or using unauthorized counterfeit shares to increase the pool of tradable common stock which operated to dilute the shares owned by Plaintiffs").[13]

146-49); (8) breach of the covenant of good faith and fair dealing, Pet. App. 99a-100a (AC ¶¶ 150-54); (9) negligence, Pet. App. 100a-01a (AC ¶¶ 155-58); and (10) punitive and exemplary damages, Pet App. 101a (AC ¶¶ 159-61).

[13] Because Escala is a thinly-traded company, naked short-selling is much more likely to materially depress the price of its stock. For large companies with many traded shares, the likelihood

These factual allegations support claims under two different New Jersey statutes, each of which constitutes a predicate act for purposes of the New Jersey Racketeering Influenced and Corrupt Organization Act, N.J. Rev. Stat. § 2C:41 *et seq.* ("NJRICO"); *see* Pet. App. 82a-93a (AC ¶¶ 88-122) (Counts One and Two).[14]

a. They constitute securities fraud under New Jersey's Uniform Securities Law, (1997) N.J. Rev. Stat. § 49:3-47 *et seq.* ("NJUSL").[15] Pet. App. 85a (AC ¶ 99)

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that a short position will be quickly matched with a long position is high, even if a specific long cannot be immediately located. For companies with only a small amount of actively traded shares, the odds are higher that shorts will not find corresponding longs, in which case "counterfeit" shares that dilute the value of actual shares are effectively created. *See generally Key Points about Regulation SHO*, SEC Office of Investor Education and Advocacy (April 8, 2015), http://www.sec.gov/investor/pubs/regsho.htm.

[14] The New Jersey legislature enacted NJRICO in 1981 "to provide that activity which is inimical to the general health, welfare and prosperity of the State and its inhabitants be made subject to strict civil and criminal sanctions." N.J. Rev. Stat. § 2C:41-1.1. The statute contains a liberal construction provision. N.J. Rev. Stat. § 2C:41-6. New Jersey courts have interpreted NJRICO consistent with that intent. *See, e.g., State v. Ball*, 661 A.2d 251, 258-59 (N.J. 1995). *See generally* John E. Floyd, *RICO State by State: A Guide to Litigation Under the State Racketeering Statutes* 520 (1998).

[15] For over 150 years, New Jersey investors have relied on state common law for protection against manipulation of the securities markets. *See, e.g., Morris Canal & Banking Co. v. Fisher*, 9 N.J. Eq. 667 (N.J. 1855) (addressing negotiability of bonds allegedly issued without stockholder authorization). Such is still the case today. *See, e.g., Prudential Ins. Co. of Am. v. Bank of Am., Nat'l Ass'n*, 14 F. Supp. 3d 591 (D.N.J. 2014) (addressing allegations of fraud and negligent misrepresentation regarding underwriting guidelines for residential mortgage backed securities). To enhance its common law protections for investors, New Jersey adopted and later amended the NJUSL, a version of the Uniform Securities Act.

(alleging that Defendants violated NJUSL "by making phantom loans of counterfeit Escala stock to facilitate naked short sale transactions . . ."). *See generally* Pet. App. 84a-87a (AC ¶¶ 96-101h).

b. They constitute theft by taking under the New Jersey Code of Criminal Justice ("New Jersey Criminal Code"), N.J. Rev. Stat. § 2C:20-4 (2013). Pet. App. 88a (AC ¶ 106) ("Defendants engaged in theft by taking by purporting to loan short sellers Escala stock that Defendants did not own nor had any intention of obtaining and never did obtain . . . ."). *See generally* Pet. App. 87a-89a (AC ¶ 106).

Second, the Amended Complaint alleges that Petitioners—in their capacity as proprietary traders—engaged in a scheme to short Escala stock which they knew or should have known they could not possibly cover, and that they used their status as brokers to conceal that scheme. *See, e.g.*, Pet. App. 44a (AC ¶ 4) ("Defendants implemented a sophisticated scheme to conceal and cover-up their illegal conduct to avoid detection."); Pet. App. 74a (AC ¶ 79a) ("[T]o conceal their unlawful naked short selling of Escala stock, Defendants . . . created false documentation of their trading . . . in Escala shares."); Pet. App. 74a (AC ¶ 79c) ("[T]o conceal their unlawful naked short selling of Escala stock, Defendants . . . knowingly and intentionally mis-marked order tickets . . . and falsely report[ed] counterfeit or phantom shares on brokerage statements to investors, including the Plaintiffs in order to mislead them.").

According to the Amended Complaint, Petitioners' motive was simple: to make money by driving down the price of Escala stock. Pet. App. 73a (AC ¶ 78) ("The data

reflects that there was an illegal bear raid on Escala securities, with massive volumes of non-existent counterfeit stock used to manipulate pricing."). By shorting more stock in a small, thinly-traded company than actually existed, Petitioners both financially gained and diluted Respondents' interest. Pet. App. 56a (AC ¶ 37a) (alleging harm through "creating and/or using unauthorized counterfeit shares to increase the pool of tradable common stock which operated to dilute the shares owned by Plaintiffs").

These factual allegations support claims under three different New Jersey statutes, each of which constitutes a predicate act for the purposes of NJRICO.

a. They constitute securities fraud under NJUSL. Pet. App. 85a (AC ¶ 98a) (alleging that Petitioners violated NJUSL by "selling Escala stock short at times when Defendants neither possessed nor intended to obtain Escala stock to deliver by the Settlement Date"). *See generally* Pet. App. 84a-87a (AC ¶¶ 96-101a).

b. They constitute theft by taking under the New Jersey Criminal Code, N.J. Rev. Stat. § 2C:20-4. Pet. App. 87a (AC ¶ 105) ("Defendants unlawfully took property of Plaintiffs, with the intention of depriving them of that property by . . . selling Escala stock short at times when they neither possessed nor intended on obtaining Escala stock to deliver by the Settlement Date . . . .").

c. They constitute theft by deception under the New Jersey Criminal Code, N.J. Rev. Stat. § 2C:20-3. Pet. App. 89a (AC ¶ 110) ("Defendants, by . . . promis[ing] to borrow Escala stock that it did not borrow and had no intention of borrowing, committed the crime of theft by

deception prohibited by N.J.S.A. 2C:20-4."). *See generally* Pet. App. 89a-113a (AC ¶¶ 108-113).

2. To be clear: the Amended Complaint explicitly does *not* assert any federal causes of action. *See* Pet. App. 82a-101a (AC ¶¶ 88-161). Nor does it allege violations of federal law or regulation as predicate acts for violations of NJRICO alleged in Counts One and Two. *See* Pet. App. 89a-93a (AC ¶¶ 88-122).

The Amended Complaint does, however, seek to educate the reader about the history of clear SEC guidance that manipulative naked short-selling is illegal under federal law and many state laws, making Petitioners' conduct especially egregious. *See, e.g.*, Pet. App. 53a (AC ¶ 30) ("[T]he SEC, which regulates federal securities laws that are substantially similar to New Jersey's Securities Act, has explicitly stated that selling stock short and failing to deliver shares at the time of settlement with the purpose of driving down the security's price constitutes a 'manipulative ... ivity' that 'in general, would violate various securities laws '").[16]

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[16] In 2004, the SEC adopted Regulation SHO to clarify that manipulative naked short-selling is illegal and to curb its spread. *See* 17 C.F.R. § 242.200 *et seq.*; Short Sales, SEC Release No. 34-50103, 69 Fed. Reg. 48,008 (Aug. 6, 2004) (codified at 17 C.F.R. pts. 240, 241 and 242) ("Regulation SHO Release"). As the SEC explained, manipulative naked short-selling is fraudulent. *See, e.g.*, "Naked" Short Selling Antifraud Rule, SEC Release No. 34-57511, 73 Fed. Reg. 61,666, 61,674 (Oct. 17, 2008) (codified at 17 C.F.R. pt. 240) ("[F]ails to deliver might be indicative of manipulative 'naked' short selling . . . ."); Office of Investor Educ. and Advocacy, SEC, Key Points About Regulation SHO, http://www.sec.gov/investor/pubs/regsho.htm ("Those who deceive about their intention or ability to deliver securities in time for settlement are committing fraud . . . when they fail to deliver securities by the settlement date."); *id.* ("Selling stock short and failing to deliver shares at the time of

The Amended Complaint also explains that the "SEC formally articulated the pernicious effects of naked short selling on the securities markets" over a decade ago in enacting Regulation SHO, Pet. App. 51a-53a (AC ¶¶ 28-29); and that the SEC had since "reaffirmed its '. . . zero tolerance for abusive naked short selling' by strengthening investor protection," Pet. App. 53a-54a (AC ¶ 30). And it describes Petitioners' history of repeated violations of Regulation SHO to explain that Petitioners had a history of sanctions by the Financial Industry Regulatory Authority and other regulatory agencies and thus punitive damages would be warranted. *See* Pet. App. 75a-82a (AC ¶¶ 81-87) (discussing history of sanctions by the FINRA and other regulatory agencies).

3. Petitioner Merrill Lynch, Pierce, Fenner & Smith ("Merrill") filed a Notice of Removal. Pet. App. 26a. Petitioners contended that removal was proper because (1) the claims in the Amended Complaint "arise under" federal law and therefore confer federal question jurisdiction pursuant to 28 U.S.C. § 1331, and (2) the federal district court was vested with exclusive jurisdiction under Section 27 of the Exchange Act.

Respondents then moved to remand. Pet. App. 26a. As Respondents explained, there was no "arising under" jurisdiction under 28 U.S.C. § 1331 because they could establish each of their state law claims without reference to federal law. *See, e.g.*, Motion to Remand, ECF No. 11-2, at 16 ("Here, Plaintiffs can prevail . . . without relying

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settlement with the purpose of driving down the security's price . . . would violate various securities laws, including Rule 10b-5 under the Exchange Act.").

on or proving a violation of federal law by demonstrating that Defendants engaged in deceptive conduct in never intending to make delivery of the shorted Escala stock."); Pls.' Reply, ECF No. 30, at 2 ("It is the intent and effect of Defendant[s'] wrongful conduct that serves as the measure of liability for Defendants' violation of state RICO and other common law claims, not the violation of any federal regulation or rule.").

Respondents also explained that the exclusive jurisdiction provision in Section 27 of the Exchange Act does not apply because Respondents sought to vindicate only their rights under New Jersey law:

> Because Plaintiffs' claims arise out of *state* law rights and duties, Plaintiffs have *state* law rights to be free from fraud, misrepresentation, and material omissions in the sale of securities, *state* law rights to be free from market manipulation and *state* law rights to be free from deceit and theft.... [New Jersey] provide[s] claims for relief from abuses in the securities field independent of and in addition to federal claims for relief....

Motion to Remand, ECF No. 11-2, at 16-17 (emphasis in original).

4. Recognizing that none of Respondents' claims is predicated on an alleged violation of federal law, the federal magistrate judge recommended remanding the action. Pet. App. 9a (Third Circuit discussing Magistrate Judge's Report and Recommendation).

First, the magistrate rejected Petitioners' argument that there is "arising under" jurisdiction:

> Plaintiffs correctly note that, because they may succeed on their New Jersey RICO claims (Counts 1-2) and state common law claims (Counts 3-10) without establishing liability under federal law, the Amended Complaint . . . does not raise necessarily a substantial issue of federal law.

Report and Recommendation, ECF No. 36, at 8.

Next, the magistrate rejected Petitioners' alternative argument that there is exclusive jurisdiction in federal court pursuant to Section 27 of the Exchange Act. *See* Report and Recommendation, ECF No. 36, at 10-12.

The magistrate found that the references to violations of the Exchange Act in the Amended Complaint "merely . . . support independent state causes of action." Report and Recommendation, ECF No. 36, at 10-11. *See also* Pls.' Reply, ECF No. 30, at 2 ("The gravamen underlying Plaintiffs' Amended Complaint is not that Defendants violated Reg. SHO or other federal regulations, but that by manipulating the value of Escala stock through unlawful naked short sales, Defendants engaged in a pattern of racketeering activity in violation of New Jersey law, resulting in Plaintiffs suffering significant damages.'") (cited in Report and Recommendation, ECF No. 36, at 10).

5. The district court rejected the magistrate's recommendation and denied the motion to remand. Pet. App. 25a. The court began by stating the fundamental—but mistaken—premise of its decision:

> Notably, Plaintiffs do not dispute that the alleged unlawful conduct is predicated on a violation of Regulation SHO, 17 C.F.R. § 242.204, promul-

> gated by the Securities and Exchange Commission ("SEC").

Pet. App. 29a.

The district court did not square its finding with multiple provisions of the Amended Complaint. As Respondents explained and the magistrate understood, Petitioners' unlawful conduct was violating duties owed to Respondents under New Jersey law, not federal law. *See, e.g.*, Pet. App. 43a (AC ¶ 2) (making clear that entire complaint is based on violations of state law without predication on any violation of Regulation SHO); Motion to Remand, ECF No. 11-2, at 16-17 (same); Report and Recommendation, ECF No. 36, at 10-11 (recognizing same).

Resting entirely on its original premise, the district court nevertheless found exclusive jurisdiction under Section 27 of the Exchange Act, *see* Pet. App. 30a-32a, as well as "arising under" jurisdiction, *see* Pet. App. 32a-38a. *See* Pet. App. 32a ("As the case at bar is premised upon and its resolution depends upon the alleged violation of a regulation promulgated under the Act, this Court has jurisdiction."); Pet. App. 33a ("To prevail on their various state law claims, . . . Plaintiffs must show that the alleged naked short sales were illegal.").

6. The Third Circuit reversed. Pet. App. 6a. First, the Third Circuit rejected Petitioners' argument that there is "arising under" jurisdiction. Pet. App. 11a-18a. It determined that Petitioners referred to violations of federal law merely as atmospheric evidence that similar New Jersey state law was violated. *See* Pet. App. 14a-15a (citing *Lippitt v. Raymond James Fin. Servs., Inc.*, 340 F.3d 1033, 1037 (9th Cir. 2003) (no jurisdiction even where the complaint "unnecessarily describes the

alleged conduct of the defendants in terms that track almost verbatim the misdeeds proscribed by [federal law].") (alteration in original)).

In this case, the Third Circuit concluded, "no causes of action are predicated *at all* on a violation of Regulation SHO." Pet. App. 14a (emphasis in original). *See also* Pet. App. 13a ("Regulation SHO is not an element of Plaintiffs' claims.... The claims, therefore, could be decided without reference to federal law.").[17]

Second, the Third Circuit considered—for the sake of argument—what result would obtain if Respondents' claims "were partially predicated on federal law." Pet. App. 15a (emphasis omitted). The Third Circuit determined that *if* a state law claim has a sufficient "federal ingredient" to satisfy 28 U.S.C. § 1331, then Section 27 of the Exchange Act makes that jurisdiction "exclusive." Pet. App. 20a, 22a. If the state law claim, however, does *not* include a sufficient federal ingredient to satisfy 28 U.S.C. § 1331, then Section 27 provides no alternative means to confer jurisdiction. Pet. App. 20a, 22a.

SUMMARY OF ARGUMENT

Contrary to Petitioners' contention, Section 27 of the Exchange Act does not aggressively strip away traditional state-court jurisdiction over ordinary state-law claims simply because there is a *mere possibility* that some issue related to the Exchange Act *might*

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[17] *See also* Pet. App. 18a ("Plaintiffs' claims could rise or fall entirely based on the construction of state law."). And Petitioners' arguments that federal law contradicted Respondents' claims did not authorize removal under the well-pleaded complaint rule. Pet. App. 16a-18a.

prove relevant. Petitioners' view of the law is indefensible in multiple respects, and it should be rejected.

I. Petitioners' jurisdictional theory flunks every modern mode of statutory analysis.

A. Petitioners misread Section 27's plain text. There is no basis for saying that Congress intended federal courts to displace state courts whenever a plaintiff happens to mention an Exchange Act "violation" in his complaint. Even on Petitioners' own admission, Congress wanted certain suits in federal court so federal courts could *decide* securities issues—not so federal courts could resolve purely state-law claims whenever a plaintiff mentions a federal "violation" in passing. Congress created jurisdiction in federal courts because the Act gave rise to direct criminal liability (and related civil enforcement provisions); it needed to authorize federal courts to hear *those* claims, not state-law suits, under state law, that have no business directly punishing or enforcing "violations" of the Act.

Nor are Petitioners correct that Respondents' action falls within Section 27 by somehow seeking to enforce Regulation SHO. That theory is not even factually presented, since Respondents' complaint unequivocally does *not* seek to enforce any component of federal law. In form and substance, the complaint asserts state-law claims seeking to invoke independent standards under New Jersey's civil jurisprudence. Regulation SHO has nothing to do with Respondents' ability to prevail on these claims.

In any event, Section 27 is textually limited to suits brought to enforce liabilities and duties *created by the Act*, not liabilities and duties *created by state law*. A

state-law cause of action is brought to enforce a liability "created" under state law. It makes no difference that a state standard may *mirror* the federal standard. The content of state law is still determined by the State's political branches. It is the State's decision to shape its own duties and liabilities however it wishes, even if that means *replicating* federal law. Congress expressly preserved the States' role in regulating securities by authorizing state-created "rights and remedies" "in addition" to those under the Act. Litigants are entitled to pursue those rights, rather than federal rights, in seeking relief for unlawful conduct. And suits seeking those state-created rights are indisputably *not* brought to enforce anything *created by the Act* itself. If Congress were unhappy with that result, it would not have limited Section 27's jurisdictional sweep to matters *created by the Act* while simultaneously authorizing matters *not created by the Act*.

This Court has further confirmed that Section 27's language means what it plainly says. In *Matsushita Electric Industrial Co. v. Epstein*, 516 U.S. 367 (1996), this Court examined a state-law claim, acknowledged that it turned on an embedded Exchange Act issue, and *still* refused to dislodge state-court jurisdiction—all because the state-court action "was not 'brought to enforce' any rights or obligations under the Act." *Id.* at 381-82, 382 n.7. Actions under state law seek to enforce *duties and liabilities under state law*. Petitioners offer no reason this Court should flatly depart from its holding in *Matsushita*.

B. Nor can Petitioners square their expansive reading of Section 27 with its critical surrounding provisions. The Securities Act's anti-removal provision used the same jurisdictional language as the

Exchange Act—"all suits in equity and actions at law brought to enforce any liability or duty created by th[e Act]." But it also prohibited parties from "remov[ing]" cases "brought in any State court of competent jurisdiction" that "aris[e] under th[e Act]." 15 U.S.C. § 77v. The language defining each category is technically different, but it is inconceivable that Congress intended any daylight between actions to "enforce" the Act and actions "arising under" the Act. Yet according to Petitioners, cases that merely "enforce" a federal right (without arising under federal law) form the *exclusive* subset that can be removed to federal court. This leaves federal claims in state court and state claims in federal court—exactly the opposite of any sensible interpretation.

C. Petitioners' understanding of Section 27 directly conflicts with this Court's consistent characterization of Section 27 itself and analogous statutes. In a long line of cases, this Court has invoked Section 27 and described it (in passing) as covering cases "arising under" the Act. This Court chooses its words carefully, and it is well accustomed to reading jurisdictional provisions. If Section 27 textually embraced the extraordinary sweep that Petitioners urge, surely the Court would have noticed before now. Casual readings are often natural readings, and this Court's language in those cases confirms Section 27's plain and ordinary meaning.

Moreover, this Court has twice construed this key language in cases where it actually mattered. It construed the language in *Matsushita* in a manner impossible to square with Petitioners' reading. And it construed materially indistinguishable language in *Pan American Petroleum Corporation v. Superior Court of Delaware for New Castle County*, 366 U.S. 656 (1961),

and again reached the same conclusion: Section 27 was not intended as a sharp departure from the jurisdictional norm, but rather codified the usual jurisdictional principles that respect the proper relationship between federal and state courts.

D. Contrary to Petitioners' contention, an unprecedented exclusion of state judicial authority is unnecessary to advance Congress's statutory objectives. Uniformity was assuredly important to Congress, but it did not pursue that goal at all costs. Quite the contrary, the Exchange Act reflects Congress's careful balancing of federal and state interests. Congress directly authorized states to regulate in the area, and it indisputably tolerated state courts reviewing federal claims (as defenses and counterclaims), just as Congress tolerates similar incursions to "uniformity" in virtually every other "exclusive jurisdiction" setting. Petitioners' flawed views would upset the concurrent roles Congress preserved for state law and state courts. And this is no minor deal: it is simply breathtaking to presume that Congress would rather uproot a broad swath of state-law claims from state courts just to avoid the possibility that state courts might occasionally resolve a matter of federal law. Congress does not endorse such remarkable intrusions on the federal-state relationship in such subtle (and counter-textual) ways.

II. Petitioners' "federal possibility" theory invites a radical and unsound departure from one of the most enduring and fundamental principles of federal jurisdiction.

A. There is no principle of law or logic that permits exclusive federal jurisdiction to turn on the mere *possibility* that a claim might rely on a federal violation.

Congress is well aware how to eliminate all state-court control over certain federal issues—it is called complete preemption. Yet Congress refused to include anything approaching that high standard in Section 27. As with all other statutes, Congress drafts jurisdictional statutes against the backdrop of settled and accepted principles. In this area, there are few principles more settled or accepted than the notion that mere "possibilities" are not enough: federal jurisdiction requires that the federal ingredient be a *necessary* component of a state-law claim. Petitioners admit they cannot meet that bedrock standard here, and they are wrong to suggest Congress threw it out the door without so much as a hint it was embracing such a drastic shift.

B. Unlike Petitioners' theory, a more traditional view of Section 27 is sound in principle and workable in practice. Adhering to traditional concepts (those that have served the courts well for centuries) ensures that courts and litigants can operate under a known, predictable, administrable standard. In many cases, it will be highly difficult to determine whether a state-law claim is actually "enforcing" some unspecified federal law. It avoids messy disputes over efforts to read federal issues between the lines of purely state-law claims (as here), and it prevents eliminating state-court jurisdiction only so federal courts can entertain countless state-court actions that are ultimately resolved without any remote airing of any federal issue. Congress does not divest an entire category of state judicial authority in such a haphazard fashion. Petitioners' theory is fundamentally unsound, and it should be rejected.

ARGUMENT

Petitioners are correct that the "jurisdictional test" established by Section 27 is "clear and simple." Pet. Br. 2. But they have gotten that simple test wrong.

These facts are undisputed: Respondents alleged ten claims below, and not a single one necessarily turns on federal law. Each and every claim was a product of New Jersey law, and premised on duties and liabilities created by New Jersey, not Congress. Each and every claim has at least some means of prevailing without uttering a single syllable on the Exchange Act or its regulations.

In fact, putting aside Section 27, none of these claims would even conceivably belong in federal court by themselves. Under any existing, ordinary jurisdictional analysis, the states would retain their authority to adjudicate matters of state law in their own state courts. In other words, there is not a jurisdictional test that exists today, in any other area or form, that would even permit these claims to enter federal court, much less to eliminate state judicial authority in the process.

Petitioners, however, do not advance any ordinary or existing jurisdictional theory. On the contrary, Petitioners have introduced a new concept of federal jurisdiction, one based on the mere possibility that a federal issue might arise in the case. According to Petitioners, the fact that a single claim might possibly turn on a federal regulation is sufficient to eviscerate state-court jurisdiction and remove the entire dispute to federal court—even if the case never ultimately raises a single federal ingredient.

As explained below, Petitioners are wrong. There is no such thing as "federal possibility" jurisdiction. Section 27 nowhere hints of such a radical intrusion on

traditional state authority, or such a stark departure from the most fundamental and enduring principles of federal jurisdiction. Congress crafted Section 27 to usher true federal claims to federal court; it did not intend or allow the complete displacement of the state judiciary whenever a state-law complaint mentions federal law.

The decision below should be affirmed.[18]

I. Section 27 of the Exchange Act Was Not Intended to Strip State Courts of Jurisdiction Over State-Law Claims That Might Turn on Federal Law.

Petitioners cannot prevail without establishing that Section 27 embraces exclusive jurisdiction whenever there is a mere possibility that a federal issue under the Exchange Act will arise. Petitioners' theory is at odds with Section 27's plain text, incompatible with its surrounding provisions, out of step with this Court's

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[18] Petitioners devote several pages of their brief ascribing error to the court of appeal for "[holding] that § 27 does not grant jurisdiction at all, but instead merely deprives state courts of jurisdiction when federal jurisdiction would exist under another provision, such as § 1331." Pet Br. at 28-32. With all due respect to Petitioners, they have misconstrued the decision below. In rejecting the position urged by Petitioners, the Third Circuit concluded the jurisdictional scope of Section 27 is no broader than Section 1331, and therefore simply meant to say that Section 27 could not supply an independent *conceptual* basis for awarding jurisdiction. Accordingly, while the Third Circuit's decision admittedly relies on jurisdictional concepts embodied in 1331 (something the Petitioners believe, incorrectly, is error), it did not formally hold, as Petitioners claim, that Section 27 could "not grant jurisdiction at all" were 28 U.S.C. § 1331 repealed. In any event, that debate is academic because, whether Section 27 of the Exchange Act is a "standalone" grant of jurisdiction or not—it simply does not reach claims like those of Respondents.

cases, and inconsistent with legislative intent. Congress does not typically abandon centuries of jurisdictional practice by saying so little and meaning the opposite of what it said. Petitioners' theory must be rejected.

A. Petitioners Misread the Text of Section 27.

In Section 27 of the Exchange Act, Congress specifically granted district courts "exclusive jurisdiction" over "violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder." 15 U.S.C. § 78aa(a). In arguing that "section 27 confers exclusive federal jurisdiction over respondents' complaint," Pet. Br. 19 (capitalization removed), Petitioners advance two textual arguments. Neither is correct.

1. In passing, but repeatedly, Petitioners maintain that there is exclusive federal jurisdiction over this case simply because the Amended Complaint *asserts* that Petitioners violated Regulation SHO, irrespective of *any* connection to an actual claim. *See, e.g.*, Pet. Br. 2 ("The jurisdictional test established by th[e] language [of Section 27] is clear and simple: if the complaint on its face alleges a violation of the Act or its regulations . . . then federal courts have exclusive jurisdiction.").[19]

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[19] Petitioners repeat this assertion throughout their opening brief. *See* Pet. Br. 17 ("federal courts have exclusive jurisdiction when a complaint alleges 'violations of' the Exchange Act or its regulations"); *id.* at 23 ("if the complaint on its face asserts a violation of the Act or its regulations . . . the complaint is subject to the exclusive jurisdiction of the federal courts"); *id.* at 34 ("The rule established by § 27's plain text could hardly be clearer: whether the complaint on its face asserts a violation of the Act or its regulations or seeks to enforce a duty thereunder.").

This reading of Section 27 is untenable. Consider a garden-variety state law breach-of-contract action in which plaintiff alleges, for atmospherics, that defendant is a bad actor who recently violated the Exchange Act. Under Petitioners' theory, Section 27 would divest the state court of jurisdiction—despite the contract claim having nothing whatsoever to do with the background allegation. There is no reason to believe that Congress intended such an absurd result.

Of course, there is a far simpler and more sensible reading of the phrase vesting "exclusive jurisdiction of violations of th[e Act]." 15 U.S.C. § 78aa(a). And that reading is made clear from the very next two sentences of Section 27—which describe venue for criminal proceedings and civil-enforcement actions asserting "violations" of the Act. *See id.* ("Any criminal proceeding may be brought in the district wherein any act or transaction constituting *the violation* occurred. Any suit or action . . . *to enjoin any violation* of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found . . . .") (emphases added).

Put simply, Congress referred to exclusive jurisdiction of "violations of this chapter" as distinct from "all suits in equity and actions at law brought to enforce any liability or duty created by this chapter" because the former phrase was needed to confer jurisdiction over lawsuits to criminally punish or civilly enjoin violations of the Exchange Act.[20]

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[20] Of course, "violations of this chapter" will often subject the violator to "liability." *See, e.g.*, 15 U.S.C. § 78ff(c)(1)(A) ("Any issuer that violates subsection (a) or (g) of section 78dd–1 of this title shall be fined not more than $2,000,000.") If a lawsuit is *actually*

2. Alternatively, Petitioners argue that Section 27 eliminates state court jurisdiction over Respondents' suit because Respondents' state law claims indirectly seek to enforce "duties" imposed by a federal regulation:

> The complaint . . . seeks "to enforce dut[ies] created by [the Act] or the rules and regulations thereunder," *id.*, because respondents' complaint seeks to hold petitioners liable for violating the "locate" and "close-out" duties of Regulation SHO. The fact that respondents seek to enforce those duties though state-law causes of action does not matter, because the statute applies broadly to "*all* suits in equity and actions at law brought to enforce" duties created by the Exchange Act or its regulations."

Pet. Br. 21. Again, Petitioners are mistaken.

a. As an initial matter, Petitioners' theory is based on a factual premise that was *expressly rejected* by the Third Circuit—*i.e.*, that at least one of Respondents' causes of action might somehow require a judicial determination that Regulation SHO had been violated.

"brought to enforce [that] liability," it would surely be subject to exclusive federal jurisdiction. But *whether Respondents' lawsuit* was "brought to enforce any liability" resulting from an Exchange Act violation is the very disputed issue in this case. Petitioners cannot obtain reversal by merely accusing Respondents of "alleg[ing] a violation of the act or its regulation." Such an accusation begs the relevant question—*i.e.*, whether Petitioners' lawsuit is actually "brought to enforce any liability" resulting from the alleged Exchange Act violation. Indeed, Petitioners' own amici concede as much. *See, e.g.*, Sec. Indus. and Fin. Mkt. Assoc. Br. at 7 ("By its terms, the first clause of Section 27—the violations clause—extends to suits that, whether or not pleaded under the Exchange Act, *are predicated on alleged violations of the Act.*") (emphasis added).

See Pet. App. 14a ("As we read the Amended Complaint, no causes of action are predicated *at all* on a violation of Regulation SHO.") (emphasis in original). The court of appeals was correct.

There is no mention of Regulation SHO (or any federal law) in *any* of the 73 paragraphs of the Amended Complaint setting forth Respondents' claims against Petitioners. *See* Pet. App. 82a-93a (AC ¶¶88-122). Put simply, Respondents do not need to prove anything about Regulation SHO to establish their state law claims. And their state law RICO claim turns entirely on state law predicates, none of which invokes Regulation SHO or even mirrors its terms. Indeed, the only conceivable role Regulation SHO will have in this case is *as a defense*—should Petitioners argue that New Jersey law is conflict preempted because of Regulation SHO. A federal issue arising as a defense is categorically irrelevant for purposes of "exclusive jurisdiction" under Section 27.

Nor does it make one whit of difference that the fact section of Respondents' Amended Complaint references Regulation SHO and explains that Petitioners have violated it in the past. These references did not seek "a judicial determination that . . . Regulation SHO . . . was violated." Pet. Br. 3. To the contrary, those references simply illustrated that Petitioners had a history of sanctions by the Financial Industry Regulatory Authority and other regulatory agencies and thus punitive damages would be warranted against them. *See* Pet. App. 75a-82a (discussing history of sanctions by the Financial Industry Regulatory Authority and other regulatory agencies). Indeed, the bulk of these particular references involved *other parties and other events*, "violations" that obviously have nothing to do

with proving the underlying merits of any claim in *this* case.[21]

b. In any event, Petitioners misread Section 27's plain terms. On its face, Section 27 is textually limited to suits brought to enforce liabilities and duties "*created by [the Exchange Act],*" not liabilities and duties *created by state law.* A suit asserting claims under state law, invoking state-created rights and remedies, is not a suit brought to *enforce* federal law.

This is the most natural reading of the text. A state lawsuit is by definition brought to enforce a liability "created" under state law; the liability would not exist but for the state's decision to create the cause of action, and any "liability" is authorized by the state itself, not federal law. When a court enters judgment on a state law claim, it is awarding relief based on the "liability and duty" *created by state law.* If the state repealed those rights and remedies, the action would fail—even if the same rights and remedies were found independently in the Exchange Act.

Nor does it matter if state law is modeled after federal standards. State regulation is still *state* regulation. When a party invokes state law, it is invoking "any and all other rights and remedies that may exist," *i.e.*, those of the state, 15 U.S.C. § 78bb(a)(2), and those rights and remedies are created by the state. The fact that the state elected to mirror federal law (if that is

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[21] A fair reading of the complaint, as confirmed by the court of appeals, confirms that the factual predicate for Petitioners' theory simply does not exist. This is a complaint with claims based exclusively on state law—in every respect. Because the question presented is not actually presented on these facts, the Court should consider dismissing the petition as improvidently granted.

what it did) is irrelevant to the *source* of the rights invoked in state court. The operative question under Section 27's text is which body of law "created" the liabilities and duties at issue. There is no basis in law or logic for saying that a right created by state law (in every sense of the word) is actually a right created by federal law just because one resembles the other.[22]

Petitioners' contrary position misunderstands the nature of state regulation. States, as independent sovereigns, may prohibit in their own law (and make actionable in their own courts) whatever conduct they choose. Congress did not "create" any state laws, and the SEC did not promulgate any New Jersey regulations pursuant to the Exchange Act. These are New Jersey rights created by its legislature, and their content is dictated by New Jersey law. They survive independently of any federal law or regulations.

Indeed, Congress expressly preserved the States' independent regulation in this area, 15 U.S.C. § 78bb(a)(2), including the power to authorize additional rights and remedies. If Congress wanted those rights and remedies adjudicated exclusively in federal court, it would have said so. It instead limited Section 27's jurisdictional provision to liabilities and duties *created by the Act*—at the same time it explicitly contemplated

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[22] If Federal Law *A* bars Misconduct *X*, and New Jersey Law *A* bars Misconduct *X*, then only claims relying on the former can be said to have brought to enforce duties "created by" Federal Law *A*. For example, if New York also enacted laws that barred Misconduct *X*, a New Jersey suit entirely invoking New Jersey law seeking to remedy Misconduct *X* could not be said to be enforcing duties created by New York law, even though New York law would be consonant with the result.

additional rights *not created by the Act*. Petitioners' theory is simply incompatible with the statutory text.

c. For the same reasons, certain amici are also wrong that Petitioners can dodge Section 27's textual requirements by focusing on the source of the claim: "[n]either prong of Section 27 turns on whether the Exchange Act itself creates the *claim* that is being asserted, and thus it is irrelevant whether the asserted claims purport to arise under state law." NASDAQ et al. Br. 7 (emphasis in original).

Section 27 expressly requires the suit to enforce a duty or liability "*created by [the Exchange Act]*." A suit to enforce liabilities or duties under state law is not a suit to enforce liabilities or duties created by the Act—and that holds true even if the state's substantive law tracks some federal standards.

Again, the content of a state's substantive law is reserved to the state's political branches. States may decide to mirror federal law or deviate from federal law, just as New Jersey is alleged to depart from federal law here. A suit enforcing those policy determinations is one enforcing a *state* rule or regulation, not a *federal* rule or regulation. So even if the Exchange Act need not "create the claim that is being asserted," the claim still must be brought to enforce the Exchange Act's provisions—not state law standards that voluntarily (and unremarkably) overlap (or are entirely coterminous) with federal law.

3. This Court has already construed this language to mean exactly what it says. In *Matsushita Electric Industrial Co. v. Epstein*, 516 U.S. 367 (1996), the Court confronted a state law claim alleging corporate waste by "exposing the corporation to liability under the [Exchange Act]," and the Court still held that the state

court retained jurisdiction: it made no difference that "the plaintiff class premised one of its claims of fiduciary breach" on a federal allegation because "the cause pleaded was nonetheless a state common-law action for breach of fiduciary duty." *Id.* at 382 n.7. The Court thus specifically held that "[t]he Delaware court asserted judicial power over a complaint asserting purely state-law causes of action," and thus "the Delaware action was not 'brought to enforce' any rights or obligations under the Act." *Id.* at 381-82.

Petitioners' reading of Section 27 is impossible to square with *Matsushita*. A suit seeking relief on state-created "rights or obligations" is *not* seeking to enforce any "rights or obligations" under the Act, even if aspects of the claim are premised on federal law. It is still the *state*, not the federal government, that elected to make federal law relevant, and it is still a state-created "liability or duty" that will be the ultimate source of any judgment.

Petitioners attempt to brush aside *Matsushita* as holding only that state courts can review and approve proposed *settlements* of federal claims. Pet. Br. 24. *Matsushita* indeed did hold exactly that, but it was not *all* that *Matsushita* held. *See* 516 U.S. at 380-86, 389 n.7. The predicate question was whether the state court was properly exercising jurisdiction in the first place. *Id.* at 375. Were it the rule that any incorporation of federal law into a state-created right defeated state jurisdiction, *Matsushita* would have come out exactly the other way. Petitioners' view is directly at odds with *Matsushita*'s holding and its plain-text reading of Section 27's unambiguous language. Petitioners are thus right that "[j]urisdiction is not always so simple, but that is no reason to complicate things when it is." Pet. Br. 2. Both

Section 27 and *Matsushita* mean what they say, and Petitioners lose for exactly those reasons.

B. Petitioners' Reading of Section 27 Is Irreconcilable With Identical Language in the Securities Act.

At best, the meaning of Section 27 in this context is ambiguous, requiring an examination of the Act's "broader structure":

> [W]e must turn to the broader structure of the Act to determine the meaning of [the provision]. "A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme . . . because only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law." *United Sav. Assn. of Tex. v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365, 371, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988).

King v. Burwell, 135 S. Ct. 2480, 2492 (2015) (quoting *United Sav. Assn. of Tex. v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365, 371 (1988)). But Petitioners urge this Court to do precisely the opposite: to read an ambiguous provision in a way that would render a related provision absurd.

The Securities Act uses the terms "created by" and "arising under" to refer to the same universe of claims. Although certain amendments have altered the statute's functional reach, the law authorizes federal jurisdiction over certain claims while simultaneously prohibiting removal of those same claims:

> The district courts of the United States . . . shall have jurisdiction . . . with respect to . . . all suits in equity and actions at law brought to enforce

> any liability or duty created by this subchapter. . . . [Yet] no case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States.

15 U.S.C.A. § 77v. This provision, admittedly, is one designed to preserve concurrent jurisdiction. But the *way* the provision uses "created by" and "arising under" to preserve concurrent jurisdiction is telling. For this provision to make sense, Congress must have considered the set of suits enforcing duties "created by" the Securities Act *to be no more expansive* than the set of suits "arising under" the Securities Act.

This provision alone shows the impossibility of Petitioners' reading of Section 27. Petitioners have argued that "created by" has a broader jurisdictional reach than "arising under," with "created by" reaching state law claims that might possibly turn on federal law, and "arising under" only reaching claims that, among other things, *necessarily* turn on federal law. If Petitioners are right about the meaning of "created by," then here is how the above provision reads:

> The district courts of the United States . . . shall have jurisdiction . . . with respect to . . . all suits **that *might* turn on federal law**. . . . [Yet] no case **that *necessarily* turns on federal law** brought in any State court of competent jurisdiction shall be removed to any court of the United States.

That Congress would want to bar removal with respect to claims that actually turned on federal law but permit removal for claims that might turn on federal law is, respectfully, absurd.

C. Petitioners' Reading of Section 27 Is Irreconcilable With This Court's Long-standing Interpretation of the Precise Statutory Phrase at Issue.

Petitioners cannot square their novel and sweeping view of Section 27's language with this Court's consistent interpretation of exactly the same language in Section 27 itself and analogous statutes.

1. For decades, this Court has described Section 27 as a traditional "arising under" jurisdictional grant. *See, e.g., Radzanower v. Touche Ross & Co.*, 426 U.S. 148, 159 (1976) (Stevens, J., dissenting) (Section 27 addresses cases "arising under" the Exchange Act); *Will v. Calvert Fire Ins. Co.*, 437 U.S. 655, 670 (1978) (Brennan, J., dissenting) ("Section 27 of the 1934 Act . . . gives the federal courts exclusive jurisdiction over claims arising under the Act.") (emphasis omitted).

While the Court has often invoked those characterizations in passing, they still underscore a fundamental point: Section 27's plain text is most naturally read—as one does in passing—to mean exactly what this Court has repeatedly said: it applies to cases arising under the Act. Petitioners' contrary view requires a startling departure from longstanding practice. If Section 27 were most naturally read to mean what Petitioners contend, the Court would likely have noticed something amiss in its past cases; there is no reason to believe that Congress would have legislated such a novel change in such a subtle fashion.[23]

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[23] Petitioners, both at the petition stage and in their merits brief, repeatedly cite dicta from prior decisions of this Court for the proposition that Section 27 of the Exchange Act confers jurisdiction. Oddly, however, they fail to acknowledge that the very same dicta

In any event, not *all* of the Court's past language on this point has been in passing. Indeed, as noted above, *Matsushita* confronted this question and read Section 27 exactly the way Respondents do. Jurisdiction is simply not triggered when a party brings suit to enforce state law liabilities and duties created by state law claims—even if aspects of those claims turn on federal law:

> While § 27 prohibits state courts from adjudicating claims *arising under* the Exchange Act, it does not prohibit state courts from approving the release of Exchange Act claims in the settlement of suits over which they have properly exercised jurisdiction, *i.e.*, suits arising under state law or under federal law for which there is concurrent jurisdiction. *In this case, for example, the Delaware action was not "brought to enforce" any rights or obligations under the Act.*

516 U.S. at 381-82 (emphasis added). And the Court reached this conclusion despite acknowledging, explicitly, that the class plaintiffs "alleg[ed]" that the defendant violated state law by "exposing the corporation to liability under [the Exchange Act]." *Id.* at 382 n.7. If Petitioners were correct, it is hard to understand how that "state common-law action for breach of fiduciary duty" was "not 'brought to enforce' rights or obligations under the Act." *Id.* at 381, 82 n.7.

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makes clear that the jurisdiction conferred by Section 27 is no broader than the familiar "arising under" language of Section 1331. And they further fail to acknowledge the critical passages, noted above, where the Court again squarely confronted the issue in a context where its language mattered. Petitioners have no obvious answer for the Court's deliberate choice of words in this setting.

2. This Court has also had an opportunity to consider the meaning of "created by" language nearly identical to that in Section 27 in a different substantive setting. In *Pan American Petroleum Corporation v. Superior Court of Delaware for New Castle County*, 366 U.S. 656 (1961), this Court considered the meaning of the Natural Gas Act (NGA)'s jurisdictional provision. The relevant NGA provision provided that federal courts "shall have exclusive jurisdiction of violations of [the NGA] or the rules, regulations, and orders thereunder, and of all . . . actions at law brought to enforce any liability or duty created" by the NGA. *Id.* at 662. This Court concluded that, based on both general jurisdictional principles and the legislative history of the act, the meaning of "brought to enforce any liability or duty created" was no broader than the meaning of "arising under" in 28 U.S.C. § 1331. *Id.* at 665 n.2.

According to Petitioners, however, *Pan American* was all about the well-pleaded complaint rule; it did not purport to equate 28 U.S.C. § 1331 and the NGA. It simply held that a federal issue arising as a defense could not satisfy the terms of the NGA's "exclusive" jurisdiction provision.

Petitioners, again, are *half*-right. But their view simply refuses to acknowledge the Court's critical footnote, which presumably meant (again) exactly what the Court said: the "exclusive" jurisdiction language was coterminous with the traditional "arising under" standard, and there was no reason to think Congress intended to depart from that settled standard. *Id.*

Petitioners' only effort to acknowledge this declaration is brushing aside the Court's direct statement as rooted exclusively in legislative history. Pet. Br. 38-39. To be sure, that legislative history—a

single snippet reproduced in the opinion—presumably did bolster the Court's conclusion, but the Court's predominant consideration was the same one that applies here: Congress legislates against the backdrop of traditional jurisdictional principles, and it presumably intends to invoke those traditional principles unless it affirmatively says otherwise. As in *Pan American*, Congress did not say otherwise here.

Petitioners accordingly err in attempting to shoehorn this discussion into the well-pleaded complaint rule. Their position is out of step with *Pan American*, and they offer no compelling basis for construing the identical language in each Act to mean two very different things. Their argument should be rejected.

D. Petitioners' Reading of Section 27 Does Not Advance the "Purposes" of the Exchange Act.

According to Petitioners, "uniformity" was the driving concern underlying Section 78aa. Pet. Br. 24. It was essential, Petitioners tell us, to preserve federal control over all features of the Exchange Act: only expert federal judges could construe and apply its provisions in a uniform, fair, and predictable manner. *Id.* at 25-27. This policy concern, Petitioners argue, warrants construing Section 27 to its outer limit: "[s]tate courts, of course, are considered competent to decide most questions of federal law," but here "Congress has concluded that state courts are not well-equipped to conduct the careful application of the sensitive federal interests." *Id.* at 27. Thus, according to Petitioners, any reading that permits state courts to resolve federal questions undermines the statutory purpose. *See, e.g.*, *id.* at 25 n.8.

Petitioners are mistaken. It is assuredly true that Congress was concerned about preserving some degree of federal uniformity. But "no legislation pursues its purposes at all costs." *Rodriguez v. United States*, 480 U.S. 522, 525-26 (1987) (per curiam). Petitioners cannot simply invoke "uniformity" and assume that *anything* promoting that value to its outer bounds is automatically correct. "[I]t frustrates rather than effectuates legislative intent simplistically to assume that *whatever* furthers the statute's primary objective must be the law." *Id.* at 526; *see also Norfolk S. Ry. Co. v. Sorrell*, 549 U.S. 158, 171 (2007).

The right question is not whether Congress felt that federal courts should retain more control than usual, but whether Congress indicated an obvious intent to advance that interest to the exclusion of everything else. Congress expressed no such intention here. Petitioners' novel theory would frustrate the careful balance Congress struck between federal and state authority, and Petitioners' reading of Section 27 is unnecessary to promote uniformity in this area. Their argument should be rejected.[24]

1. Petitioners' sweeping theory is at odds with Congress's scheme. Congress intended to preserve concurrent roles for state law and state courts in regulating securities, and Petitioners cannot seriously suggest otherwise. By its plain language, Section 27 directly contemplates that States will retain their traditional role in securities regulation, authorizing

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[24] The United States' failure to support Petitioners in this case speaks volumes about whether or not it believes claims like those made by Respondents threaten the uniformity or efficacy of federal securities regulation.

independent "rights and remedies" in addition to those found in the Act. 15 U.S.C. § 78bb(a)(2). If Congress felt that the states' participation threatened the "uniform" enforcement of the federal securities laws, it would not have expressly permitted those laws to coexist with the federal scheme.

It makes little sense to suggest that Congress permitted states to pass laws in this area, but refused to permit states to enforce those laws in their own courts whenever the subject matter overlaps too closely with federal regulation. *Matsushita*, 516 U.S. at 383 ("Congress plainly contemplated the possibility of dual litigation in state and federal courts relating to securities transactions.") (citing 15 U.S.C. § 78bb(a)).

Nor are Petitioners correct that Congress refused state courts any role in resolving federal issues under the Exchange Act. Congress indisputably accepted that *some* federal issues—even *pure* federal issues—would remain in state court. Under the well-pleaded complaint rule, for example, all federal *defenses* will be resolved in state actions, even those requiring courts to construe and apply federal law. One cannot determine the scope of federal conflict preemption, for example, without construing and applying federal law—even though that leaves state court judges to "'say definitively what the Exchange Act means and enforce legal liabilities and duties thereunder.'" Pet. Br. 24 (quoting *Matsushita*, 516 U.S. at 383). And Congress was surely aware that *federal counter-claims* would remain in state court for adjudication—a counter-claim is not a "suit" even if it "enforces" federal issues.

If Congress wanted to avoid this result, it assuredly knew how to: it could have adopted language more like SLUSA, which provides an easy model for removing all

matters involving federal securities to federal court. *See, e.g., Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 74, 82-83 (2006) (permitting removal and dismissal of all class claims alleging wrongdoing "in connection with" a covered security).

Instead, however, Congress carefully limited Section 27's "exclusive" jurisdiction to those suits particularly enforcing rights "created by" the Act itself. This may leave open the possibility of state courts adjudicating federal questions, but it also respects the natural balance that Congress struck between the state and federal systems. Just as in other common settings, Congress has refused to strip away *all* state jurisdiction in order to achieve perfect uniformity.

2. In any event, Petitioners' theory is unnecessary to accomplish Congress's objectives. Petitioners first overstate the problem: by ushering all true federal claims to federal court, Congress ensures that the federal judiciary will develop a sufficient body of law on these questions that can inform state judges when they happen to encounter federal issues. That promotes "uniformity" without disturbing the proper role Congress preserved for state courts.

And *Pan American* itself squarely refutes Petitioners' view that *any* state court adjudication is too much state court adjudication. *See* 366 U.S. at 665 (rejecting contention that "permit[ting] the state courts to entertain the [state-law] suits . . . will jeopardize the uniform system of regulation that Congress established through the Natural Gas Act"). As this Court explained, it can always ensure uniformity by reviewing cases from state courts that decide any important federal question. *Id.* at 665-66. If the Court felt that its supervisory role accommodated "uniformity" concerns under the Natural

Gas Act, it is unclear why Petitioners believe this Court's supervisory role is inadequate to accommodate the same concerns under the Exchange Act.

* * *

It is worth pausing to consider what Petitioners ask this Court to do. Petitioners ask this Court to presume that Congress was so concerned about "uniformity" that it was willing to forbid state court jurisdiction not only over federal claims, but also over any state law claim that just *might possibly* turn on federal law. Any directive forbidding state courts from determining federal claims is already unusual. But it is simply extraordinary to presume that Congress, without saying so directly, intended to intrude on the states' power in their own courts to review claims created by their own legislature, despite possibly never implicating a single federal issue. If that were truly Congress's intent, one would expect to find language far clearer than this.

In the end, Petitioners cannot use a general sense of legislative purpose to rewrite the actual text. *See, e.g.*, *Norfolk S. Ry. Co. v. Sorrell*, 549 U.S. 158, 171 (2007) ("the statute's remedial purpose cannot compensate for the lack of a statutory basis"). And in any event, Petitioners' general sense of legislative purpose is wrong. Congress wrote a measured jurisdictional statute that respects traditional jurisdictional principles and preserves the states' traditional role in this area—all while increasing uniformity by ushering the vast majority of federal issues to federal courts (in exactly the same fashion, with exactly the same exceptions, that Congress embraced in parallel contexts). The fact that Congress authorized "exclusive" jurisdiction—even to promote uniformity—does not mean that Congress stripped away state jurisdiction over common state-law

claims simply to avoid the possibility of any federal issue being resolved in a state tribunal. *Cf. Gunn v. Minton*, 133 S. Ct. 1059 (2013).

II. Petitioners' "Federal Possibility" Rule Is a Radical and Unwise Departure from One of the Most Enduring Principles of Federal Jurisdiction.

According to Petitioners, Congress intended Section 27 to confer jurisdiction over any cause of action that *might* rely on a violation of the Exchange Act. As Petitioner puts it:

> To be clear, nothing in § 27's language states or suggests that jurisdiction attaches only if the Regulation SHO violations and duties alleged in the complaint are *necessary* elements of respondents' claims. The language instead provides that when a violation or duty of the Act or its regulations is asserted, a federal court is the only court that can decide whether the alleged violation occurred or the duty was breached. It is accordingly irrelevant that other grounds also may provide a basis for liability—§ 27's text bars a state court from even considering whether the asserted violation occurred or the asserted duty was breached, because those matters are subject to the exclusive jurisdiction of the federal court. The presence of those allegations in a state-court complaint justifies removal, even if the complaint also asserts other possible bases for liability.

Pet. Br. at 22 (emphasis in original).

As Petitioners would have it, the mere possibility of a federal issue is enough for jurisdiction. As explained below, Petitioners' view is radical, unwise, and contrary to this Court's sensible jurisdictional modesty. Indeed,

just two years after the passage of the Exchange Act, no less a jurist than Justice Cardozo rejected the kind of "federal possibility jurisdiction" put forth by Petitioners. *See Gully v. First National Bank*, 299 U.S. 109, 117, 118 (1936) ("[A] dispute so doubtful and conjectural" is not sufficient to divest a state court of jurisdiction; "[t]he most one can say is that a question of federal law is *lurking in the background.*") (emphasis added).

Also telling is that, although Section 27 has been law for over eight decades, absent from Petitioners' brief is even a single citation to a judicial decision that has adopted Petitioners' position. If Congress had intended for federal possibility jurisdiction, it seems unlikely that this particular innovation would have escaped notice for 81 years. More likely is that Petitioners are alone in their error. It should remain that way.

A. It Is a Bedrock Presumption That, Absent Complete Preemption, There Is No Federal Jurisdiction Over State Law Claims Unless They *Necessarily* Raise a Federal Issue.

Petitioners' view is a monumental departure from the traditional rules of federal jurisdiction. It is a bedrock presumption that state-law claims must (at a minimum) *necessarily* raise a federal issue to create jurisdiction: "'[A] right or immunity created by the Constitution or laws of the United States must be an element, and an essential one, of the plaintiff's cause of action.'" *Franchise Tax Bd. of Cal. v. Construction Laborers Vacation Trust for S. Cal.*, 463 U.S. 1, 10-11 (1983) (quoting *Gully v. First Nat'l Bank in Meridian*, 299 U.S. 109, 112 (1936)) (emphasis added).

Petitioners concede, as they must, that none of Respondents' claims *necessarily* turns on federal law.

But, according to Petitioners, that is irrelevant because "nothing in § 27's language states or suggests that jurisdiction attaches only if the Regulation SHO violations and duties alleged in the complaint are *necessary* elements of respondents' claims." Pet. Br. 22.

This is twice wrong. First, it flips the relevant standard on its head. The presumption is that traditional jurisdictional principles apply, not the other way around. The question is thus not whether "§ 27's language states or suggests" that the traditional rules apply, but whether Petitioners have identified any reason to think otherwise. *See, e.g.*, *Pan American*, 366 U.S. at 665 n.2 (refusing to set aside traditional limits on jurisdiction simply because the Natural Gas Act did not explicitly invoke those traditional "limitations"). Petitioners have wholly failed in that regard.

Second, in any event, Petitioners again misread Section 27's text. The traditional rule recognizes that suits do not truly arise under federal law—or enforce any rights under federal law—when they assert independent state-law theories sufficient to resolve the dispute. Any claim that does not have an essential federal ingredient is not *necessarily* brought to enforce federal law. It is *possibly* brought to enforce federal law, and there is no such thing as "federal possibility" jurisdiction. The fairest reading of Section 27 is that claims are "brought" to enforce a duty when they necessarily present the question.

This Court has taken pains to be clear about what it means by "necessary." The jurisdiction triggering issue must be unavoidable; alternate theories that *could* invoke the issue are an insufficient basis for jurisdiction. *Cf. Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 809-10 (1988) ("[A] claim supported by

alternative theories in the complaint may not form the basis for § 1338(a) jurisdiction unless patent law is essential to each of those theories."). In *Christianson*, after examining both patent law and generally applicable principles of jurisdiction, the Court declared that jurisdiction turns on "claims, not theories." *Id.* at 811.

A Congressional provision of exclusive jurisdiction is not a sufficient reason to relax the necessity requirement. Even in that context, this Court has insisted that only state-law claims that, *inter alia*, "necessarily raise a stated federal issue" can be heard in federal court. *Gunn v. Minton*, 133 S. Ct. 1059, 1065 (2013) (quoting *Grable & Sons Metal Products, Inc. v. Darue Engineering & Mfg.*, 545 U.S. 308, 314 (2005)).

B. The Federal Necessity Presumption Is Easily Administrable and Strikes the Appropriate Balance Between Federal and State Interests.

1. Making jurisdiction dependent on the federal issue being a necessary one is a condition consonant with this Court's institutional reluctance to expand federal jurisdiction absent pellucid Congressional command. The requirement that the federal issue be essential to the state claim avoids unnecessarily divesting state courts of authority (whether systematically if federal jurisdiction is exclusive, or in only certain cases via removal if federal jurisdiction is concurrent) over state law disputes, and federalism presumptively respects a state's prerogative to enact laws that promote the welfare of its citizens and to resolve disputes over those laws, without federal interference.

Indeed, absent that solicitude, the well-pleaded complaint rule would make little sense. That long-settled

rule denies general federal question jurisdiction, as well as other more specific types of federal question jurisdiction, to any case that does not present a federal issue on the face of the well-pleaded complaint, even if a federal issue is certain to appear as a defense or in a counterclaim. *Holmes Group, Inc. v. Vornado Air Circulation Systems, Inc.*, 535 U.S. 826, 831-32 (2002); *Franchise Tax Bd. v. Constr. Laborers Vacation Trust*, 463 U.S. 1, 9-10 (1983), *superseded by* 28 U.S.C. § 1441(e); *Louisville & Nashville R.R. Co. v. Mottley*, 211 U.S. 149 (1908).

The well-pleaded complaint rule thus guarantees that issues of federal law raised in defenses and counterclaims are routinely decided by state courts in the context of state law claims. That has not troubled this Court, even in areas of exclusive federal jurisdiction where the Congressional interest in uniformity is heightened. *See, e.g.*, *Holmes Group*, 535 U.S. at 831-32 (rejecting federal jurisdiction in cases involving a patent-law counterclaim); *Cf.* 13D Charles A. Wright & Arthur R. Miller, *Federal Practice and Procedure: Jurisdiction* § 3584 (3d ed. 2002) (explaining that "an affirmative defense based upon federal law, including the Exchange Act, may be adjudicated by a state court"). State law decisions on federal law are not binding outside the State, and even within the State, the appellate process (aided by SEC intervention where appropriate) is likely to correct an erroneous reading of federal law. Should that fail, review by this Court can address the problem.

2. Petitioners fail to acknowledge a very real harm of their "federal possibility" rule: it *guarantees* state courts will be divested of jurisdiction in cases in which no actual federal issue is ultimately reached. Litigants (or aggressive judges) would only need identify a potential

federal issue relevant to the claims asserted to unlock the doors of federal court; whether that issue was ever reached (or even likely to be reached) would not matter. If possibility rather than necessity is sufficient to trigger jurisdiction, federal courts would routinely decide purely state-law claims. Necessity imposes a meaningful limit on the divestment of state court jurisdiction; possibility does not.[25]

3. Nor is Petitioners' rule practical. Necessity as a jurisdictional minimum makes sense because it is workable. When federal necessity is the test, a judge reading a state law complaint need only confirm a proffered state law theory could legitimately vindicate the state law claims; if so, states retain jurisdiction. In contrast, under Petitioners' approach, judges would be obligated to examine the factual allegations of all complaints to determine whether those allegations corresponded to an Exchange Act violation that would aid the prosecution of a state law claim; only after such a searching review, and a rejection of that possibility, could the case proceed in state court. Petitioners will presumably protest that, here, Respondents mentioned Regulation SHO in the complaint, and therefore their test is easy to apply. But rules transcend cases. As a hypothetical plaintiff would not need to name the Act to plead facts that would (1) constitute a violation or breach of duty under the Act and (2) therefore might serve as a potential ingredient in a plaintiff's state law claim,

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[25] And given that state courts, under the well-pleaded complaint rule, *already* decide Exchange Act claims or issues that arise in the context of counterclaims or defenses, the incremental benefit of a "federal possibility" rule—limiting state courts from weighing in on federal questions embedded in state law claims—seems modest.

Petitioners' rationale would reach, and require examination of, unlabeled factual allegations.

4. Ultimately, Petitioners know that under traditional jurisdictional principles and assumptions—that state-law claims should not be heard in federal court absent a necessary federal ingredient; that states are presumed competent arbiters of federal law; and that conflict preemption can protect federal substantive interests—Petitioners lose (as they did below). They therefore must insist here that such principles, and jurisdictional restraint generally, are specific to Section 1331 and play no meaningful role in Section 27. Pet. Br. 34-35 (arguing that this Court's narrow interpretation of "arising under" is attributable to policy reasons specific to Section 1331).

Petitioners credit the rooster for the sunrise. Professions of jurisdictional caution draw vitality from this Court's commitment to federalism, not something peculiar about Section 1331. Section 1331 is admittedly the context in which this Court most frequently has the opportunity to express restraint, but a reluctance to interfere with state laws and tribunals does not vanish merely because Section 1331 is not at issue. *Cf. Gunn v. Minton*, 133 S. Ct. 1059, 1064 (2013) (holding that 28 U.S.C. § 1338 cannot reach state law claims that fail to "necessarily raise a stated federal issue"); *Holmes Group, Inc. v. Vornado Air Circulation Sys., Inc.*, 535 U.S. 826 (2002), *superseded by* 28 U.S.C. § 1295(a)(1) (applying well-pleaded complaint rule to patent claims); *Matsushita Electric Industrial Co., Ltd. v. Epstein*, 516 U.S. 367 (1996) (explaining that a state law derivative claim that might turn on an Exchange Act violation is still properly before a state court); *Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 809-10 (1988)

(denying Section 1338 jurisdiction unless patent law is essential to each theory of a claim); *Shamrock Oil & Gas Corp. v. Sheets*, 313 U.S. 100, 109 (1941) (articulating, in a diversity setting, this Court's "[d]ue regard for the rightful independence of state governments"); *Strawbridge v. Curtiss*, 7 U.S. 267 (1806) (adopting complete diversity rule). Honest federalism requires jurisdictional restraint, across contexts, and that is a truth this Court has never failed to recognize.

Given the above, one would therefore expect unmistakable language from Congress were it to invent a heretofore unprecedented "federal possibility" jurisdictional paradigm that would throw open federal court to anyone capable of identifying, from the vast universe of federal regulations promulgated under the Act, a single regulation potentially at issue.[26] To the contrary, all the relevant contextual evidence is that Congress meant nothing of the sort. If Congress intended so stinging a rebuke to state courts as Petitioners' federal possibility jurisdiction, it would have done so plainly.

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[26] Congressional desire for uniformity cannot be enough, as the Court has not jettisoned traditional jurisdictional principles in those settings. *See, e.g.*, *Gunn v. Minton*, 133 S. Ct. 1059 (2013); *Holmes Group, Inc. v. Vornado Air Circulation Systems, Inc.*, 535 U.S. 826 (2002); *Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800 (1988).

CONCLUSION

For the reasons set forth above, the judgment of the Third Circuit should be affirmed.

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Supreme Court, U.S.
FILED
OCT 30 2015
OFFICE OF THE CLERK

No. 14-1132

IN THE

Supreme Court of the United States

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., *ET AL.*,

Petitioners,

v.

GREG MANNING, *ET AL.*,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF OF AMICUS CURIAE PUBLIC CITIZEN, INC., IN SUPPORT OF RESPONDENTS

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October 2015

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INTEREST OF AMICUS CURIAE[1]

Public Citizen, Inc., is a consumer advocacy organization with members and supporters nationwide. Since its founding in 1971, Public Citizen has appeared on behalf of its members before Congress, administrative agencies, and courts on a wide range of issues and has worked for enactment and enforcement of laws protecting consumers, workers, and the public.

Public Citizen has a longstanding interest in the proper construction of statutory provisions defining and limiting the jurisdiction of the federal courts. The resolution of such issues often has significant impacts on the efficacy of statutory and common-law remedies under both state and federal law, as well as on the allocation of power in our federal system and the proper implementation of congressional intent. Public Citizen attorneys have therefore frequently represented parties or amici before this Court in cases involving significant issues of federal jurisdiction, including questions of original, removal, and appellate jurisdiction.[2]

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[1] This brief was not authored in whole or part by counsel for a party. No one other than amicus curiae or its counsel made a monetary contribution to preparation or submission of this brief. Letters of consent to filing from counsel for all parties are on file with the Clerk.

[2] *See, e.g.*, *Dart Cherokee Basin Operating Co. v. Owens*, 135 S. Ct. 547 (2014); *Miss. ex rel. Hood v. AU Optronics Corp.*, 134 S. Ct. 736 (2014); *Mims v. Arrow Fin. Servs., LLC*, 132 S. Ct. 740 (2012); *Powerex Corp. v. Reliant Energy Servs., Inc.*, 551 U.S. 224 (2007); *Kircher v. Putnam Funds Trust*, 547 U.S. 633 (2006); *Will v. Hallock*, 546 U.S. 345 (2006).

SUMMARY OF ARGUMENT

The question posed by this case is not whether section 27 of the Securities Exchange Act, 15 U.S.C. § 78aa, is a jurisdictional statute, but whether the federal question jurisdiction it confers sweeps more broadly than that granted by the general federal-question jurisdiction statute, 28 U.S.C. § 1331, over cases arising under the laws of the United States.

This Court has long construed § 1331's broad grant of federal question jurisdiction to comprehend virtually all actions asserting rights of action created by federal law. At the same time, the Court has construed § 1331's grant of jurisdiction to include only a few exceptional cases outside those bounds. That small category of cases encompasses only actions in which the plaintiff's well-pleaded complaint reveals that its affirmative claims necessarily depend on a substantial, disputed issue of federal law that requires a federal forum. See *Gunn v. Minton*, 133 S. Ct. 1059, 1065 (2013). In this case, the lower courts have held that the claims fall outside § 1331, and Merrill Lynch does not challenge those rulings here.

The Exchange Act's jurisdictional provision does not command a different result. The provision, in language also used in a handful of other statutes, provides for jurisdiction over actions seeking to "enforce any liability or duty created by this [Act]." Those words, read in light of their natural meaning and this Court's longstanding reluctance to give overbroad readings to jurisdictional grants, are no broader than those of § 1331's grant of jurisdiction over cases "arising under" federal law. Indeed, this Court held more than fifty years ago that the language used in the Exchange Act provision is congruent with § 1331's "aris-

ing under" standard. *See Pan Am. Petroleum Corp. v. Super. Ct.*, 366 U.S. 656 (1961). Merrill Lynch offers no reason for overturning that reading.

The Exchange Act's grant of jurisdiction over "violations" likewise is not a font of expansive jurisdiction: Its natural meaning and effect is to provide jurisdiction over enforcement and criminal actions seeking statutory penalties for violations and over actions brought to enjoin violations of federal law. It is not a source of jurisdiction over damages actions, *see Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11, 21–22 (1979), let alone damages actions based on state law.

Nor does the statute's grant of "exclusive" jurisdiction call for a broader construction. The Exchange Act's jurisdictional provision defines the scope of federal jurisdiction in terms identical to other statutes that grant non-exclusive jurisdiction to federal courts. The meaning of those terms does not vary depending on whether they are incorporated in a statute that makes the resulting jurisdiction exclusive. "Exclusiveness is a consequence of having jurisdiction, not the generator of jurisdiction ...." *Pan Am. Petroleum*, 366 U.S. at 664. Merrill Lynch's policy arguments about the need for uniform interpretation of federal law are no more persuasive than those that have been advanced and rejected by other litigants seeking expansive readings of statutes granting exclusive jurisdiction. *See, e.g., Gunn*, 133 S. Ct. at 1067–68.

ARGUMENT

I. This Court has long limited statutory grants of federal question jurisdiction to cases in which federal law creates the right of action and to a small category of exceptional cases presenting claims that necessarily rest on substantial questions of federal law.

Article III of the Constitution grants Congress broad power to confer on the federal courts jurisdiction over cases "arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority." U.S. Const., art. III, § 2, cl. 1. Although the outer limits of that power are untested, this Court's decision in *Osborn v. Bank of the United States*, 22 U.S. 738 (1824), "reflects a broad conception of 'arising under' jurisdiction, according to which Congress may confer on the federal courts jurisdiction over any case or controversy that might call for the application of federal law." *Verlinden B.V. v. Central Bank of Nigeria*, 461 U.S. 480, 492 (1983).

For most of the first century under the Constitution, Congress declined to exercise its authority to confer sweeping federal question jurisdiction on the federal courts, and instead granted the federal courts relatively narrow authority over particular types of federal claims. Beginning in 1875, however, Congress broadly granted federal trial courts jurisdiction—in terms mirroring those used in Article III—over cases "arising under the Constitution or laws of the United States, or treaties made, or which shall be made, under their authority." Jurisdiction & Removal Act of 1875, ch. 137, § 1, 18 Stat. 470. That jurisdictional

grant, the forerunner of today's general federal-question jurisdictional statute, 28 U.S.C. § 1331, ushered in an era in which deciding cases based on federal law has increasingly come to be seen as a preeminent task of the federal court system.

For much of that new era, until the elimination of § 1331's amount-in-controversy requirement in 1980, *see* Federal Question Jurisdictional Amendments Act of 1980, Pub. L. No. 96-486, 94 Stat. 2369, more specific grants of federal question jurisdiction over cases involving particular areas of federal law, without amount-in-controversy limits, supplemented § 1331 by conveying more expansive authority over areas where Congress thought that the availability of a federal forum was particularly important. In some instances, moreover, statutes granted exclusive federal jurisdiction over cases arising under particular types of federal law.

Although Congress used broad language to accomplish the transformation in the business of the federal courts that the ascendancy of statutory federal question jurisdiction has brought about, this Court has never interpreted these statutory jurisdictional grants as sweepingly as Article III would theoretically allow. Rather, the construction of federal-question jurisdictional statutes has been guided by "the deeply felt and traditional reluctance of this Court to expand the jurisdiction of the federal courts through a broad reading of jurisdictional statutes." *Romero v. Int'l Terminal Operating Co.*, 358 U.S. 354, 379 (1959).

In particular, the Court has been concerned that reading such statutes as broadly as the Constitution's own "arising under" language would "permi[t] 'assertion of original federal question jurisdiction on the

remote possibility of presentation of a federal question.'" *Verlinden*, 461 U.S. at 492 (quoting *Textile Workers Union v. Lincoln Mills*, 353 U.S. 448, 482 (1957) (Frankfurter, J., dissenting)). Such a broad construction of federal jurisdictional statutes, the Court has recognized, could distort congressional judgments about the proper division of federal- and state-court authority over cases involving issues of federal law. Thus, the Court has "consistently emphasized" that "determinations about federal jurisdiction require sensitive judgment about congressional intent, judicial power, and the federal system." *Merrell Dow Pharm. Inc. v. Thompson*, 478 U.S. 804, 810 (1986). The Court has "forcefully reiterated the need for prudence and restraint in the jurisdictional inquiry," *id.*, and construed the scope of statutory grants of federal question jurisdiction "with an eye to practicality and necessity," *Franchise Tax Bd. v. Constr. Laborers Vacation Trust*, 463 U.S. 1, 20 (1983), as well as due recognition that expansive assertion of federal question jurisdiction "always raises the possibility of upsetting the state-federal line drawn (or at least assumed) by Congress." *Grable & Sons Metal Prods., Inc. v. Darue Eng'g & Mfg.*, 545 U.S. 308, 314 (2005).

Applying the broad statutory language of Congress's grants of federal question jurisdiction consistently with these principles of restraint, the Court has identified a solid core of cases almost invariably subject to statutory federal question jurisdiction: "when federal law creates a private right of action and furnishes the substantive rules of decision, the claim arises under federal law, and district courts possess federal-question jurisdiction" unless Congress has acted to divest them of it. *Mims v. Arrow Fin. Servs.*,

LLC, 132 S. Ct. 740, 748–49 (2012). Put more simply, in Justice Holmes's famous aphorism, "A suit arises under the law that creates the cause of action." *Am. Well Works Co. v. Layne & Bowler Co.*, 241 U.S. 257, 260 (1916). The rule that "a case arises under federal law when federal law creates the cause of action asserted," as this Court recently stressed, "accounts for the vast bulk of suits that arise under federal law." *Gunn v. Minton*, 133 S. Ct. at 1064; *accord, e.g.*, *Merrell Dow*, 478 U.S. at 808; *Franchise Tax Bd.*, 463 U.S. at 9.

Although statutory federal question jurisdiction will almost always exist over a case asserting a right of action created by federal law, the Court has acknowledged that this principle is "more useful for inclusion than for ... exclusion." *Merrell Dow*, 478 U.S. at 809 n.5 (quoting *T.B. Harms Co. v. Eliscu*, 339 F.2d 823, 827 (2d Cir. 1964)). The Court has recognized that in some exceptional cases, actions asserting rights of action created by state law that necessarily pose substantial federal-law issues may be deemed to be subject to federal question jurisdiction. *See, e.g.*, *Grable*, 545 U.S. at 314; *Smith v. Kansas City Title & Trust Co.*, 255 U.S. 180 (1921). The circumstances under which such actions may serve as the basis for invocation of federal question jurisdiction, however, have long been carefully limited by this Court.

The Court has insisted, for example, that to give rise to jurisdiction, the existence of a federal question must appear on the face of a well-pleaded complaint. *Franchise Tax Bd.*, 463 U.S. at 9–10. That a federal issue may be implicated by a defense to a right of action—even one that is anticipated in the complaint itself or that serves as the basis for a declaratory

judgment action—does not suffice to allow statutory federal question jurisdiction. *Louisville & Nashville R.R. v. Mottley*, 211 U.S. 149 (1908); *Skelly Oil Co. v. Phillips Petroleum Co.*, 339 U.S. 667, 673 (1950). And it is not enough that a federal question "is lurking in the background" of a case. *Gully v. First Nat'l Bank*, 299 U.S. 109, 117 (1936). "Not every question of federal law emerging in a suit is proof that a federal law is the basis of the suit"; rather, "a right or immunity created by the Constitution or laws of the United States must be an element, and an essential one, of the plaintiff's cause of action." *Id.* at 115, 112.

The Court has recently crystalized these principles "into the following inquiry: Does the 'state-law claim necessarily raise a stated federal issue, actually disputed and substantial, which a federal forum may entertain without disturbing any congressionally approved balance of federal and state judicial responsibilities'?" *Gunn*, 133 S. Ct. at 1065 (quoting *Grable*, 545 U.S. at 314). "That is, federal jurisdiction over a state law claim will lie if a federal issue is: (1) necessarily raised, (2) actually disputed, (3) substantial, and (4) capable of resolution in federal court without disrupting the federal-state balance approved by Congress." *Id.* The Court emphasized that the set of cases meeting these criteria is "special and small" and that this "slim category" is reserved for "only extremely rare exceptions" to the general rule that a case falls within federal question jurisdiction if federal law created a right of action it asserts. *Id.* at 1064–65.

II. The Securities Exchange Act's jurisdictional provision and similar provisions in other statutes do not confer jurisdiction more broadly than the general federal-question jurisdictional statute.

A. As this case comes before the Court, it has been established that the claims asserted do not meet the *Gunn-Grable* criteria for the invocation of general federal question jurisdiction over state-created rights of action. The Third Circuit so held, and Merrill Lynch neither sought review of that ruling in its petition for certiorari nor contested the issue in its brief on the merits. Rather, Merrill Lynch's sole assertion is that section 27 of the Exchange Act, 15 U.S.C. § 78aa, confers jurisdiction over a broader set of cases that potentially implicate issues of federal law than do 28 U.S.C. § 1331 and other jurisdictional statutes that employ its "arising under" language.

The Exchange Act is one of a small set of statutes, most enacted during the New Deal era, providing federal district-court jurisdiction over "violations of this [Act] or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this [Act] or the rules and regulations thereunder." 15 U.S.C. § 78aa(a). Other examples include:

- the Securities Act of 1933, 15 U.S.C. § 77v(a);
- the Public Utility Holding Company Act of 1935, former 15 U.S.C. § 79y;
- the Federal Power Act of 1935, 16 U.S.C. § 825p;
- the Connally Hot Oil Act of 1935, 15 U.S.C. § 715i(c);
- the Natural Gas Act of 1938, 15 U.S.C. § 717u;

- the Trust Indenture Act of 1939, 15 U.S.C. § 77vvv(b);
- the Investment Company Act of 1940, 15 U.S.C. § 80a-43;
- the Investment Advisers Act of 1940, 15 U.S.C. § 80b-14(a);
- the International Wheat Agreement Act of 1949, 7 U.S.C. § 1642(e);
- and the Interstate Land Sales Full Disclosure Act of 1968, 15 U.S.C. § 1719.

In addition to their nearly identical language conferring jurisdiction over "violations" as well as "suits in equity and actions at law brought to enforce any liability or duty created by" the relevant federal statute, the provisions were all enacted when the general federal-question jurisdictional statute had a substantial amount-in-controversy requirement, which each of these special jurisdictional provisions lacked. Though the scope of the jurisdiction they describe is identical, the statutes differ in that some (including the Exchange Act, the Federal Power Act, the Hot Oil Act, and the Natural Gas Act) confer "exclusive" jurisdiction on the federal courts, while the rest do not.

Notably, these statutes use a *narrower* definition of the scope of jurisdiction than does 28 U.S.C. § 1331, which tracks the Constitution's sweeping "arising under" language. Merrill Lynch's submission that by using narrower language they confer jurisdiction more broadly than does § 1331 is unusual, to say the least. Contrary to Merrill Lynch's argument, that paradoxical result is by no means compelled by the plain language of these jurisdictional provisions and is

contradicted by this Court's longstanding construction of them.

Merrill Lynch's contention that a statute conferring jurisdiction over actions "brought to enforce any liability or duty created by this Act" sweeps more broadly than § 1331 finds little grounding in the statute's actual words. Particularly when read in light of the Court's "traditional reluctance" to construe jurisdictional statutes broadly, *Romero*, 358 U.S. at 379, the words seem most readily adapted to confer jurisdiction over rights of action created by the federal laws in question—that is, to express the Holmesian view of the scope of statutory federal question jurisdiction as encompassing suits arising "under the law that creates the cause of action." *Am. Well Works*, 241 U.S. at 260. Congress's choice of narrower language than that used in § 1331 to describe the scope of jurisdiction, moreover, may well have stemmed from uncertainty regarding the limits of § 1331's "arising under" jurisdiction in light of this Court's decisions at the time, *compare Gully*, 299 U.S. at 112–13, *with Smith*, 255 U.S. at 199, and an impulse to describe the limits on statutory federal question jurisdiction more precisely.

Not surprisingly, therefore, when this Court has engaged with this jurisdictional language, it has construed it to be congruent with the more limited view of § 1331 that the Court has generally adhered to from *Gully* onward rather than as encompassing a radical expansion of jurisdiction. Thus, in *Pan American Petroleum Corp.*, the Court, construing the identically worded jurisdictional provision of the Natural Gas Act, 15 U.S.C. § 717u, held that a suit invoking a state-created right of action was outside the scope of

federal court jurisdiction, notwithstanding that it might implicate issues under the Natural Gas Act, because the action was "based upon claims arising under state, not federal, law." 366 U.S. at 663.

The Court relied throughout its analysis on cases decided under the general federal-question jurisdiction statute and other statutes employing the standard "arising under" terminology, including *Gully* and *Skelly Oil*, and *The Fair v. Kohler Die & Specialty Co.*, 228 U.S. 22 (1913). And it dismissed as immaterial the difference between the "arising under" language and that used in the Gas Act's jurisdictional provision: It explicitly stated that its reliance on "arising under" precedents was "not affected by want of explicit limitation to jurisdiction 'arising under' the Natural Gas Act. Such limitation is clearly implied ...." *Id.* at 665 n.2.

The Court's opinion in *Matsushita Electrical Industrial Co. v. Epstein*, 516 U.S. 367 (1996), while terser, reflects a similar construction of the jurisdictional language at issue. In *Matsushita*, the Court held that while a state court may not adjudicate claims arising under the Exchange Act, a state-court action may *settle* (with preclusive effect) Exchange Act causes of action subject to exclusive federal jurisdiction under 15 U.S.C. § 78aa(a), as long as the state court properly had jurisdiction over the action in the first instance. *See id.* at 381. In so holding, the Court pointed out that the state-law claims originally filed in state court were not subject to exclusive federal jurisdiction because they were claims "arising under state law" and were thus not "'brought to enforce' any rights or obligations under the Act." *Id.* at 381.

The Court's earlier decision in *Deckert v. Independence Shares Corp.*, 311 U.S. 282 (1940), similarly indicates that the jurisdictional language at issue is directed at rights of action arising under federal law. In *Deckert*, the Court considered whether the Securities Act of 1933 created a right of action for rescission and restitution to redress violations of the Act, and whether such an action fell within the jurisdiction granted by the Securities Act's jurisdictional provision, 15 U.S.C. § 77v(a). That provision, in language identical to the relevant terms of the Exchange Act provision at issue here, gives district courts jurisdiction (albeit nonexclusive) over actions "brought to enforce any liability or duty created by this [Act]." In deciding both issues in the affirmative, the Court emphasized that the jurisdiction to "enforce" was "the power to make effective *the right of recovery afforded by the Act*." 311 U.S. at 288 (emphasis added).

This Court's precedents construing the language at issue thus reinforce its most natural reading in light of the Court's traditional approach to construing statutes granting federal question jurisdiction. Far from embracing an adventuresome expansion of jurisdiction far beyond that conferred by § 1331's "arising under" language, the statutory language at issue here reflects an alternative formulation aimed at the same end: bringing within the purview of the federal courts actions asserting rights of action created by federal law and, potentially, a few exceptional cases in which the complaint discloses that a substantial question of federal law is "an element, and an essential one, of the plaintiff's cause of action." *Pan Am. Petroleum*, 366 U.S. at 663 (quoting *Gully*, 299 U.S. at 112–13).

B. The statutory language granting jurisdiction over "violations" does not alter this conclusion. That language is not aimed at bringing within federal jurisdiction any complaint that describes conduct that violates federal law, but is most naturally read to confer jurisdiction over actions seeking the criminal and civil penalties the Act authorizes for violations, as well as actions seeking to enjoin violations.[3]

This construction finds strong support in this Court's decision in *Transamerica Mortgage Advisors, Inc. v. Lewis*, 444 U.S. 11 (1979). There the Court considered whether the Investment Advisers Act of 1940 conferred a private cause of action for injunctive relief or damages. The Court's decision not to find a private damages remedy in the Act rested significantly on construction of its jurisdictional provision, which at the time used language similar to that of the statute at issue here, but with an important variation: It conferred jurisdiction over "violations" and "suits in equity to enjoin any violation," but omitted the language covering "actions at law" to enforce any "liability or duty" created by the Act. *See* 444 U.S. at 21–22 & n.11.[4] Concluding that the jurisdiction over

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[3] This construction is reinforced by the fact that almost all of the statutory provisions containing the language at issue are headed "Jurisdiction of offenses and suits." "Offenses" itself is a term that is generally limited to criminal matters. *See Kellogg Brown & Root Servs., Inc. v. United States ex rel. Carter*, 135 S. Ct. 1970, 1976–77 (2015). The operative terms of these statutory provisions use the broader term "violations," but the use of the narrower term in the title provides important context suggesting that the intended meaning is actions seeking the civil and criminal penalties created by the statutes for violations.

[4] The Advisers Act was subsequently amended in 1990 so that its jurisdictional provision, 15 U.S.C. § 80b-14, like that of

(*Footnote continued*)

"violations" would not itself encompass an action at law for damages, the Court held that the absence of a grant of jurisdiction over such actions suggested that Congress had not intended to create them. *See id.* If, as Merrill Lynch now argues, jurisdiction over "violations" itself broadly included jurisdiction over damages actions alleging violations, the Court could not have drawn the inference that it drew regarding congressional intent.

Thus, neither the grant of jurisdiction over "violations" nor that over actions to enforce any "liability or duty created by the Act" suggests an intent to sweep within federal jurisdiction state-law rights of action that implicate potential violations of federal law but do not meet the criteria for arising-under jurisdiction stated in *Gunn*, *Grable*, and the earlier case law on which they are based. Such a reading by no means strips the jurisdictional provisions of the Exchange Act and similar statutes of meaning or effect. At the time these statutes were passed, the general federal-question jurisdictional grant had a substantial amount-in-controversy requirement, which increased still further in later decades before its ultimate abolition. *See Mims*, 132 S. Ct. at 747–48 & n.7. The statutes employing the language used here, by contrast, lacked jurisdictional amounts, *see Deckert*, 311 U.S. at 289–90, and thus were far from superfluous in light of the existing statutory grant of general federal question jurisdiction.

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the other statutes discussed in this brief, now covers not only "violations" and equitable suits, but also legal actions seeking to enforce "any liability or duty" created by the Act. *See* Pub. L. No. 101-429, § 401, 104 Stat. 931 (1990).

C. The Exchange Act, of course, also has the additional consequence of making the jurisdiction it describes exclusive. Contrary to Merrill Lynch's suggestion, however, the exclusivity of the jurisdiction does not imply a broader scope. This Court made exactly that point in *Christianson v. Colt Industries Operating Corp.*, 486 U.S. 800 (1988), where it rejected the view that 28 U.S.C. § 1338(a)'s grant of jurisdiction over cases arising under the patent laws is broader than § 1331's general grant of federal question jurisdiction merely because it is exclusive. Because both statutes define the scope of jurisdiction using the same language, "linguistic consistency" demands that they be given the same limits. *See id.* at 808–09. Thus, cases under § 1338(a), like those under § 1331, are subject to the well-pleaded complaint rule and limited to rights of action created by federal law and the small category of exceptional cases that meet the criteria laid out in *Grable* and *Gunn*. *See Gunn*, 133 S. Ct. at 1064.

Likewise, policy arguments based on the exclusive nature of the jurisdiction play no role in determining the scope of jurisdiction conferred by the Exchange Act, as exactly the same language is used to define the scope of *non-exclusive* jurisdiction conferred by other statutes. The language at issue (conferring jurisdiction over "violations of this Act" and suits and actions "to enforce any liability or duty created by this Act") is used to confer exclusive jurisdiction in the Exchange Act, the Federal Power Act, the Natural Gas Act, and the Hot Oil Act, and non-exclusive jurisdiction in the Securities Act, the former Public Utility Holding Companies Act, the Trust Indenture Act, the Investment Company Act, the Investment Advisers Act, the International Wheat Agreement Act, and the

Interstate Land Sales Full Disclosure Act. That language has the same meaning regardless of whether the jurisdiction it generates is exclusive. If the same type of allegations could not support concurrent jurisdiction under, say, the Securities Act, they cannot support exclusive jurisdiction under the Exchange Act.

Thus, in *Pan American Petroleum*, this Court expressly rejected the argument that the use of the word "exclusive" in the Natural Gas Act's jurisdictional grant was relevant to the scope of federal jurisdiction: "'Exclusive jurisdiction' is given the federal courts but it is 'exclusive' only for suits that may be brought in the federal courts. Exclusiveness is a consequence of having jurisdiction, not the generator of jurisdiction because of which state courts are excluded." 366 U.S. at 664. The Court specifically cited decisions giving the patent jurisdictional statute the same scope as § 1331, *see id.*, and it applied the same principle to the Natural Gas Act's jurisdictional provision.[5]

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[5] Merrill Lynch's amici curiae the Natural Gas Supply Association and the Interstate Natural Gas Association of America appear to request that this Court indicate in its decision that the jurisdictional provision of the Natural Gas Act (and presumably that of the Federal Power Act) effectively confers exclusive jurisdiction over all state-law contract claims involving wholesale natural gas (and electricity) transactions subject to the jurisdiction of the Federal Energy Regulatory Commission, as all such cases in their view involve efforts to enforce liabilities created by federally approved tariffs or rate filings. That position is inconsistent with the holding in *Pan American*, and it confuses the question of jurisdiction with a merits defense that a state-law contract claim is preempted. The argument also suggests a view that the Natural Gas Act and Federal Power Act "completely preempt" (i.e., federalize) nominally state-law claims, which

(*Footnote continued*)

Merrill Lynch's policy arguments based on the need for uniform interpretation of federal law would not suffice to justify an expansive interpretation of the Exchange Act's grant of exclusive federal jurisdiction even if the statute were open to a construction different from that of similar provisions granting non-exclusive jurisdiction. This Court has consistently rejected arguments that state courts lack competence to decide important questions of federal law that arise in state-law based actions—or even, for that matter, in actions arising under federal law. *See, e.g.*, *Gunn*, 133 S. Ct. at 1067–68; *Pan Am. Petroleum*, 366 U.S. at 665–66; *Tafflin v. Levitt*, 493 U.S. 455, 464–67 (1990).

Indeed, this Court in *Gunn* did not perceive the need for uniformity to be a sufficient basis for an expanded view of exclusive federal jurisdiction even under the patent laws, where federal law occupies the field substantively and where the need for uniformity is such that Congress vested appellate review of federal patent cases entirely in a single court of appeals. Regulation of securities, by contrast, remains an area of shared state and federal substantive authority, *see Matsushita*, 516 U.S. at 382–83, and even within the federal court system, securities cases are vulnerable to the "inconsistency ... which a multi-membered, multi-tiered federal judicial system already creates." *Tafflin*, 493 U.S. at 465. The Exchange Act offers no

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would be an unusual result for statutes that themselves do not create federal rights of action that could completely preempt state-law ones. In any event, amici's far-reaching arguments concerning particular applications of the jurisdictional language at issue to very different types of actions under different schemes of substantive law are best reserved for a case in which they are presented.

more reason than the patent law at issue in *Gunn* to believe that Congress's desire for uniformity is not adequately served by the means it chose: exclusive jurisdiction over claims arising under federal law. *See Gunn*, 133 S. Ct. at 1067.

CONCLUSION

The judgment of the Third Circuit should be affirmed.

Respectfully submitted,

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October 2015

No. 14-1132

Supreme Court, U.S.
FILED
OCT 30 2015
OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

MERRILL LYNCH, PIERCE, FENNER & SMITH, INCORPORATED; KNIGHT CAPITAL AMERICAS L.P., FORMERLY KNOWN AS KNIGHT EQUITY MARKETS L.P.; UBS SECURITIES LLC; E*TRADE CAPITAL MARKETS LLC; NATIONAL FINANCIAL SERVICES LLC; AND CITADEL DERIVATIVES GROUP LLC,

Petitioners,

v.

GREG MANNING; CLAES ARNRUP; POSILJONEN AB; POSILJONEN AS; SVEABORG HANDEL AS; FLYGEXPO AB; AND LONDRINA HOLDING LTD.,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF FOR NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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STATEMENT OF INTEREST*

Formed in 1919, the North American Securities Administrators Association, Inc. ("NASAA"), is a nonprofit organization devoted to protecting investors from fraud and abuse in the offer and sale of securities. Its 67 members include the securities regulators in Canada, Mexico, all 50 States, the District of Columbia, the United States Virgin Islands, and Puerto Rico.

NASAA members' responsibilities include registering certain types of securities offerings; licensing the firms and agents who offer and sell securities or provide investment advice; and administering, interpreting, and enforcing their States' laws addressing fraud and misconduct in the securities markets.

The important and salutary role these laws play has been recognized by this Court and Congress, including in provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 that explicitly affirm the jurisdiction of state securities regulators and make clear that "rights and remedies" available under federal law are "in addition to" those which States provide. This dual regulatory system protects investors, and, by deterring and detecting fraud and abusive conduct, promotes the strength and integrity of the Nation's securities markets. NASAA

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* Pursuant to Rule 37.6, counsel certifies that this brief was not authored in whole or in part by counsel for any party and that no person or entity other than *amicus* or counsel made a monetary contribution to its preparation or submission. Counsel for all parties have consented to its filing.

and its members have a vital interest in the proper interpretation of rules governing the relationship between federal and state securities regulation and have participated as *amicus curiae* in numerous cases in this Court and others where such questions are at issue.

This case implicates matters of direct concern to NASAA and its members. The same reasons that have impelled Congress to affirm state governments' historic power to enact and enforce their own laws in this field strongly support upholding state *courts'* role in interpreting and applying those laws and adjudicating suits claiming relief under state law when they are violated.

INTRODUCTION AND SUMMARY OF ARGUMENT

This case, fundamentally, is about federalism—and about state courts' sovereign power to adjudicate cases that arise under their own laws.

There is no disagreement that, as a result of Congress's enactment of Section 27 of the Exchange Act, federal courts have jurisdiction over suits that seek relief for any violation of that statute or its implementing regulations, irrespective of the amount in controversy or citizenship of the parties, and that such jurisdiction is exclusive. Federal courts also have jurisdiction over state law claims that arise out of the same transaction or occurrence as Exchange Act claims, 28 U.S.C. § 1367; and they have original (concurrent) jurisdiction over certain cases that allege *only* state law causes of action but nonetheless "belong[] in a federal court," based on substantial and disputed Exchange Act issues. *Grable & Sons Metal*

Prods., Inc. v. *Darue Eng'g & Manuf.*, 545 U.S. 308, 315 (2005).

Petitioners here urge this Court to extend federal jurisdiction—and *exclusive* federal jurisdiction—further still, to a broad and ill-defined set of cases whose common characteristic is that they *fail* both the traditional "creation" test, see *American Well Works* v. *Layne & Bowler Co.*, 241 U.S. 257, 260 (1916), and the *Grable* test, based on the presence of factual allegations of Exchange Act violations, the potential that a state court might "even consider[]" Exchange Act issues in adjudicating state law liability, Pet. Br. 22, or because the state duty the plaintiff seeks to enforce parallels too closely an Exchange Act rule.

There are myriad, compelling reasons why the Court should refuse petitioners' extraordinary proposal.

I. First, the "deeply felt and traditional reluctance" with which courts must approach every invitation to broadly read federal jurisdiction statutes applies with maximal force here. *Romero* v. *Int'l Terminal Operating Co.*, 358 U.S. 354, 379 (1959). The regime petitioners propose defies the rule that jurisdictional statutes must be construed with "due regard for the * * * federal system" and for the rightful place of the States. *Ibid.* Petitioners' startling suggestion that this principle is somehow confined to cases interpreting Section 1331—and does not apply to the statutory interpretation question here—is gravely mistaken. This rule of construction is a specific application of general principles that govern every claim that Congress meant to significantly alter the state-federal balance, and the Court repeatedly has relied on it in cases considering

pleas for exclusive federal jurisdiction and ones concerning the scope of exclusive jurisdiction that Congress indisputably granted. Indeed, what distinguishes this case from those prior decisions, which rejected pleas for lack of evidence of an unmistakable congressional intent, is that those cases concerned authority to adjudicate particular *federal* causes of action; petitioners ask the Court here to hold that Congress withdrew from the courts of the States the power to adjudicate cases seeking relief under *their own* laws.

II. The text, structure, and enactment history of Section 27 do not support petitioners' claim. Petitioners are quite right that Section 27 is jurisdiction-conferring. When Congress provided that federal courts "shall have exclusive jurisdiction of all violations * * *" Congress made clear that federal courts would adjudicate "all" suits enforcing the Exchange Act, without having to satisfy the amount-in-controversy requirement under 28 U.S.C. § 1331.

But petitioners are quite wrong about the scope of the jurisdiction Section 27 confers—and denies state courts. Petitioners submit that a Congress intent on conferring exclusive federal jurisdiction over state law claims and repudiating the limitations established under Section 1331 would be expected to use language *different from* the "arising under" formulation, as Section 27 does. But a legislature so motivated would not possibly pursue that purpose by enacting the language codified in Section 27—which is, petitioners concede, narrower than that in Section 1331; which does not hint at any state-displacing purpose and was "taken practically verbatim" from a provision enacted the previous year that gave *state*

courts a species of exclusive jurisdiction over *federal* claims; and which uses "created by [federal law]" language that not only evokes the historic "creation" test for federal jurisdiction but that in fact had long been given just that interpretation.

Petitioners' proposal, ostensibly derived from the "plain" words of the statute, comes eight decades after Section 27 was enacted and more than a half-century after this Court construed the essentially identical jurisdictional provision of the Natural Gas Act, concluding that the departure from "arising under" language was *not* meant to repudiate the rules for determining jurisdiction developed under the general federal question statute.[1] And their central premise is refuted in the U.S. Code itself: In the jurisdictional provision of the Securities Act, 15 U.S.C. § 77v(a), Congress used as synonyms the two phrases petitioners insist it could only have meant to express a "material[] differen[ce]." Pet. Br. 17.

Whether or not petitioners show that the words of Section 27 *could be understood* (by someone unfamiliar with the statutory context and this Court's governing precedents) as extending to cases that arise under state laws, their brief does not describe, and Section 27 does not state, a "clear" "jurisdictional test," Pet. Br. 2—or any "test." Petitioners assure the Court that their regime would retain *certain* familiar jurisdictional rules developed under Section 1331

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[1] The "jurisdiction of violations * * * and actions * * * to enforce any liability or duty created by" language common to these two statutes also appears in provisions of the Federal Power Act, 16 U.S.C. § 825p; the Connally Hot Oil Act, 15 U.S.C. § 715i(c); and the Securities Act of 1933, 15 U.S.C. § 77v(a).

(such as that federal defenses do not support federal jurisdiction) while jettisoning others (*e.g.*, the rule that factual allegations that would entitle the plaintiff to unsought federal relief do not make his case "federal"). But litigants and courts seeking to determine *which* settled principles do and do not govern under "Section 27" would have nowhere to look. It is therefore incorrect that petitioners' blank-slate "rule" is more administrable than the *Grable* multi-factor test. The *Grable* rule may produce close or uncertain cases, but, unlike petitioners' proposal, it produces an overwhelming number of clear results, identifying many disputes that all agree do not belong in federal court.

Considerations of "sound judicial policy" and regard for the statute's place in the "mosaic of federal jurisdiction laws," *Romero*, 358 U.S. at 379–380, confirm what the text, structure, and history of Section 27 already indicate: Only cases satisfying the "creation" test fall within the exclusive jurisdiction Section 27 creates, with state law claims being heard in federal courts only to the extent they belong there, under Section 1331. Unlike the novel and ill-defined regime petitioners urge the Court to launch, this construction preserves the limited character of federal jurisdiction; it ensures that parties know with considerable certainty which cases will get into federal court; it minimizes friction and complexity inherent in multi-forum litigation; and it sensibly allocates judicial responsibility, such that cases raising important and disputed *state law* questions remain within state courts' jurisdiction, while cases raising more substantial and disputed federal ones may (but need not be) heard in federal court.

III. The policy interests petitioners advance and the "premises" they ascribe to the 1934 Act do not support their extraordinary proposal. There is no question that Section 27 promotes "greater uniformity" in the interpretation of the Exchange Act, see Pet. Br. 24 (quoting *Matsushita Elec. Indus. Co.* v. *Epstein*, 516 U.S. 367, 383 (1996)), consistently with the 73rd Congress's desire to speed the development of a stable and uniform body of law under a novel federal statute enacted in response to an unprecedented economic crisis. But the Exchange Act did not pursue uniformity at all costs: The provision immediately adjacent to Section 27 affirmatively recognizes the importance of state regulation in this field, rather than a strictly uniform federal rule. Section 27's broad venue rule *increases* the likelihood of diverse federal court interpretations, and, petitioners themselves acknowledge (while casting aspersions on state courts' expertise) that Congress trusted those courts to interpret and apply the Exchange Act when raised as a preemption defense. The claimed costs to interpretive uniformity of upholding state courts' historic authority could not possibly justify the disruptive and textually unsupported regime sought here. But in any event, such costs are, for reasons this Court's decisions explain, truly negligible.

ARGUMENT

I. The Federalism-Protecting Rules That Govern Interpretation of Jurisdictional Statutes Apply Fully To Section 27

Petitioners cannot seriously deny that the jurisdictional regime they ask the Court to impose under Section 27, whereby claims that arise

exclusively under state law would be subject to federal courts' exclusive jurisdiction, represents a sharp departure from the historical allocation of judicial responsibility. And they point to no evidence that the 73rd Congress actually considered the implications for the State-federal balance of the extraordinary, if not literally unprecedented, rule petitioners urge and then made a deliberate choice to oust state courts.

Petitioners instead argue that the absence of any clear congressional directive is of no moment, because this Court's precedents calling for "due regard for the interests of the federal system" and expressing "deeply felt * * * reluctance * * * to expand the jurisdiction of the federal courts through a broad reading of jurisdictional statutes," *Romero*, 358 U.S. at 379, do not "ha[ve] anything to do with § 27," Pet. Br. 36, and relate only to the broadly-worded general federal question provision at issue in *Romero*. *Ibid.* That is mistaken.

The opinion in *Romero* itself addressed "the interpretation of judiciary legislation" generally, see 358 U.S. at 379 (noting that history of such interpretation "teaches the duty to reject treating *such statutes* as a wooden set of self-sufficient words") (emphasis added), and federalism principles have played a central role in decisions construing a vast array of jurisdictional statutes. See *Holmes Grp., Inc.* v. *Vornado Air Circulation Sys., Inc.*, 535 U.S. 826, 832 (2002) (appellate jurisdiction of Federal Circuit); *Raygor* v. *Regents of Univ. of Minn.*, 534 U.S. 533 (2002) (supplemental jurisdiction); *Shamrock Oil & Gas Corp.* v. *Sheets*, 313 U.S. 100, 109 (1941) (removal

statute); *Healy* v. *Ratta*, 292 U.S. 263, 270 (1934) (amount-in-controversy requirement).

These principles reflect important practical realities and considerations of "sound judicial policy," *Romero*, 358 U.S. at 376, relating to the workloads of the state and federal courts, their respective expertise, and the need for efficient dispute resolution. But they fundamentally express respect for the sovereignty and "rightful independence of state governments." *Holmes*, 535 U.S. at 832. See *New York* v. *United States*, 505 U.S. 144, 157 (1992) ("Our task would be the same even if one could prove that federalism secured no advantages to anyone."). How States' "laws shall be enacted; how they shall be carried into execution; and *in what tribunals*," are historic incidents of their sovereignty, *Tarble's Case*, 80 U.S. 397, 407 (1871) (emphasis added); and "a federal court's entertaining a case that is not within its subject matter jurisdiction is no mere technical violation; it is nothing less than an unconstitutional usurpation of state judicial power." 13 Charles Alan Wright & Arthur R. Miller, Federal Practice and Procedure § 3522 (3d ed. 1998).

The principles articulated in *Romero* and like cases about jurisdictional statutes are in fact a particular application of more general rules requiring that all federal statutes be construed to "avoid * * * significant constitutional and federalism questions," *Solid Waste Agency* v. *U.S. Army Corps of Eng'rs*, 531 U.S. 159, 160–161 (2001), and that the proponent of an interpretation that would disturb the state-federal balance identify a clear statement showing that Congress "in fact faced" the federalism consequences, *United States* v. *Bass*, 404 U.S. 336, 349 (1971), and

intended them. See *Raygor*, 534 U.S. at 543 ("When Congress intends to alter the usual constitutional balance between the States and the Federal Government, it must make its intention to do so unmistakably clear in the language of the statute.") (internal quotations omitted).

This Court has repeatedly applied these principles when presented with assertions that classes of suits are subject to the exclusive jurisdiction of federal courts, including in cases where statutory text made explicit that Congress meant for *some* disputes to proceed only in federal court. Thus, in Ohio *ex. rel. Popovici* v. *Agler*, 280 U.S. 379 (1930), the Court addressed a statute providing that federal courts' jurisdiction over "all suits and proceedings against * * * consuls or vice consuls," was "exclusive of the courts of the several States," *id.* At 382–383 (quoting 28 U.S.C. § 371 (1926)), and held it did not divest the courts of Ohio of jurisdiction over a divorce proceeding against the Vice-Consul of Romania, because this "pretty sweeping" language should be read in the light of States' longstanding responsibility for adjudicating divorces. *Id.* at 383. The Court held in *Hathorn* v. *Lovorn*, 457 U.S. 255 (1982), that "even a finding of exclusive federal jurisdiction over claims arising under a federal statute usually will not prevent a state court from deciding a question collaterally[,]" *id.* at 268 (internal quotation omitted), concluding that a state court had the power (and responsibility) to decide whether a proposed change in voting procedures was "covered" for purposes of Section 5 of the Voting Rights Act, even though Congress was assumed to have vested federal courts with exclusive jurisdiction to decide Section 5

coverage disputes. *Ibid.* (discussing 42 U.S.C. §§ 1973c and 1973j(f)). And in *Matsushita*, the Court addressed the provision at issue here, holding that a state court's consideration—in the course of assessing the fairness of a class action settlement—of claims that avowedly sought relief under the Exchange Act did not run afoul of Section 27's exclusivity directive. See 516 U.S. at 387.

Federalism principles have played an especially prominent role in cases where litigants have presented pleas for exclusive federal court jurisdiction over certain federal claims. In *Yellow Freight System, Inc.* v. *Donnelly*, 494 U.S. 820 (1990), the Court invoked the "system of dual sovereignty" and the "presumptive[] competen[ce]" of state courts, *id.* at 823, to reject a contention that Title VII claims could not be litigated in those courts, notwithstanding a "persuasive showing," supported with explicit statutory text, "that most legislators, judges, and administrators * * * involved in the enactment, amendment, enforcement, and interpretation" of that statute "expected that such litigation would be processed exclusively in federal courts." *Id.* at 826. And in *Tafflin* v. *Levitt*, 493 U.S. 455 (1990), the Court's consideration of the contention that Congress had withdrawn state courts' power to adjudicate civil RICO cases "beg[a]n with the axiom that, under our federal system, the States possess sovereignty concurrent with that of the Federal Government." *Id.* at 458.

Tafflin is especially instructive, because the plea for exclusivity the Court rejected was based on a federal statute, 18 U.S.C. § 3231, which reserves exclusively to federal courts jurisdiction of federal

criminal offenses, reflecting the "need for uniformity and consistency of federal criminal law," 493 U.S. at 465, and on the fact that adjudicating federal RICO suits would "require[]" state courts "to construe the federal crimes that constitute predicate acts." *Id.* at 464. The Court held that Section 3231 did not support exclusive jurisdiction, because the RICO claims plaintiffs would litigate in state court, while requiring determination of federal law, were "not [themselves] 'offenses against the laws of the United States,' and [would] not result in the imposition of [federal] criminal sanctions," *ibid.* (quoting Section 3231)—and because the practical effect for decisional uniformity would be "negligible," *id.* at 465. See pp. 33–34, *infra*.

The burden on petitioners here is necessarily far more demanding than in those cases. Unlike in *Yellow Freight* or *Hathorn*, the class of cases at issue here are not ones that have long been or were expected to be litigated in federal forums, let alone exclusively there. (And *Tafflin*, unlike this case, involved the practical certainty, not a remote "possibility," that the "exclusive" federal statute would supply an ingredient in the state court's ultimate determination, see Resp. Br. at 23). But most important, each of those decisions insisted upon "unmistakable," "explicit," and "clear," evidence that Congress meant to withdraw from state courts their power to decide *federal law* causes of action. What petitioners ask here strikes far closer at the core of the States' sovereignty, denying their courts the power to adjudicate disputes that seek relief only under their own laws.

II. The Jurisdiction Section 27 Confers on Federal Courts (and Withdraws from State Courts) Is Limited To Claims Created By the Exchange Act

A. The Text, Structure, and Enactment History of Section 27 Contradict Petitioners' Proposed Rule

Petitioners do not point to anything in the circumstances of Section 27's enactment history that suggests that Congress made a considered judgment to divest state courts of their historic power to hear state law claims. (The immediately adjacent provision of the 1934 Act expressly saves those causes of action from preemption, see pp. 29–30, *infra*). Nor do they point to any support in the legal background that supports their interpretation, and they acknowledge that this Court's most directly relevant precedent, *Pan American*, which specifically addressed the relationship between the statutory language and Section 1331, presents grave difficulties for their thesis. See Pet. Br. 38–39.

Rather, petitioners stake their argument on the text of the statute, first arguing that Section 27 should be understood as "jurisdiction conferring," pointing to Congress's use of "shall have jurisdiction" language, and then asserting that: (1) Congress's use of language "conspicuously different" from the familiar Section 1331 "arising under" formulation, Pet. Br. 35 (quoting *Consumers Imp. Co.* v. *Zosenjo*, 320 U.S. 249, 253 (1943)); (2) its commitment to exclusive federal court adjudication; and (3) the "unambiguous" meaning of the "violations" and "[suits] to enforce * * * duties created by [the Act]"

language together establish that Section 27 enacted petitioners' broad and unusual regime.

Petitioners are quite right that Section 27 is a grant of jurisdiction independent of that conferred by Section 1331. By enacting the "shall have * * * jurisdiction" language in Section 27—and in provisions of other contemporary statutes, see note 1, *supra*—the 73rd Congress plainly *did* grant federal courts jurisdiction over certain suits that would otherwise have been subject to state court adjudication under the federal question statute: *i.e.*, ones raising Exchange Act claims that did not meet the then-governing amount-in-controversy requirement. See *Deckert* v. *Independence Shares Corp.*, 311 U.S. 282, 289–290 (1940) (quoting 15 U.S.C. § 717v(a) and holding that "the Securities Act confer[red] jurisdiction of the suit * * * irrespective of the amount in controversy," because "[t]his is plainly a suit to enforce a liability or duty created by the Act").

But, as the precedents discussed in Part I instruct, the fact that Congress intended for some exclusive jurisdiction does not say anything about the *scope* of jurisdiction it conferred on the federal courts and meant to deny the States. It is more than plausible that Congress chose to provide a federal forum for "any" and "all" suits raising Exchange Act (or Natural Gas Act, see *Pan American*) claims, by relieving plaintiffs of the need to establish—and courts of the need to determine—that Section 1331's $3,000 amount-in-controversy requirement was satisfied, without further intending to divest state

courts of their power to hear cases seeking only state law relief.[2]

1. The fact that Congress employed the "violations * * * and actions to enforce * * * duties created by" language in Section 27, instead of "arising under," does not in itself establish, as petitioners insist, that Congress chose that formulation for "*the purpose*" of "accomplish[ing]" the diminution of state court jurisdiction they urge. Pet. Br. 35 (emphasis added).

That language was "taken practically verbatim out of the Securities Act [of 1933]," 6 *Legislative History of the Securities Act of 1933 and Securities Exchange Act of 1934* 6577 (comp. by J.S. Ellenberger & E. Mahar 1973) ("Leg. Hist."), and Congress's decision to provide for exclusive, rather than concurrent, jurisdiction over Exchange Act claims was made at the very last stages of the law's enactment, without any recorded debate, see 78 Cong. Rec. 78 Cong. Rec. 8099, 9939 (1934), foreclosing any suggestion that Congress faced up to the disruption of the state-federal balance petitioners' interpretation would work. See *Tafflin*, 493 U.S. at 461 (refusing to find exclusive jurisdiction over federal claim when there was "no evidence that Congress even considered [that]"). But see Pet. Br. 18 (asserting that "the core

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[2] Although the language and context support that Section 27 was meant to confer jurisdiction, the bulk of the provision's text (and that of siblings in other statutes) address matters of venue and service of process, *i.e.*, *which* federal courts would have jurisdiction. Congress answered *that* question broadly and in ways that were ground-breaking. See *Leroy* v. *Great W. United Corp.*, 443 U.S. 173, 188 (1979).

purpose of § 27 was to ensure that such cases are adjudicated exclusively by federal courts").[3]

Moreover, the method that petitioners say Congress "chose" to bring about this extraordinary jurisdictional regime is, to say the very least, startlingly indirect. Had the 73rd Congress meant to extend jurisdiction to cases beyond the outer bounds of Section 1331, it seems unlikely it would have opted for language that is, by *petitioners'* admission, *less* encompassing than "arising under." See Pet. Br. 17.

This Court's 1961 opinion in *Pan American* said that identical language in 15 U.S.C. § 717u, the jurisdiction provision of the Natural Gas Act, *should not* be interpreted as expressing an intent to deviate from the rules developed under Section 1331 for determining federal jurisdiction. See *Pan Am. Petroleum Corp.* v. *Superior Court*, 366 U.S. 656, 665 n.2 (1961). Petitioners strain to minimize that decision's significance, noting, *inter alia*, that the Court's conclusion relied "solely" on the Natural Gas Act's legislative history and that the Exchange Act's legislative history contains no comparable explanation of Section 27. Pet. Br. 39. It would be remarkable, however, for the Court to accord different meaning to identically worded, contemporaneously-enacted provisions, based on differences in the

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[3] As the Exchange Act worked its way through Congress, the few mentions of Section 27 described it as "*merely* provi[ding] for the jurisdiction of the courts for violation of the act," 6 Leg. Hist. at 6577 (emphasis added), or, somewhat more expansively, as vesting federal courts with "jurisdiction of offenses and violations of any provision of the bill, and also of suits brought to enforce any liability or duty created by it." *Id.* at 6640.

measures' *committee reports*—and all the more so to justify different constructions based on the *absence* of certain language from the legislative history of one of the statutes. But petitioners' argument asks still more: They invite the Court to infer from these differing committee reports that the same Congress used essentially identical ("jurisdiction of violations * * * *") language to accomplish *diametrically opposite* purposes, effecting a dramatic break from the jurisdictional status quo in Section 27 of the Exchange Act while codifying developed "arising under" principles in Section 22 of the Natural Gas Act.[4]

In fact, the U.S. Code itself definitively refutes the assumption that Section 27's particular language should be taken as a repudiation of the familiar "arising under" jurisprudence. As respondents highlight, the parallel provision of the Securities Act from which Congress adopted the Section 27 language "practically verbatim," see p. 15, *supra*, plainly uses the phrases "violations * * * [and] suits to enforce duties * * * created by [the Act]" and "cases arising under [the Act]" as interchangeable equivalents. Resp. Br. 36 (discussing and quoting 15 U.S.C. § 77v(a)).

2. Nor does the fact that Congress opted for exclusive jurisdiction in Section 27, see Pet. Br. 37, mean that a uniformity-promoting purpose may be

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[4] As explained below, petitioners' further claim, that *Pan American* endorsed "only" the well-pleaded complaint rule (and in particular, the sub-principle that a federal law *defense* does not establish federal jurisdiction), creates even more serious difficulties for their argument. See pp. 21–23, *infra*.

imputed to the provision's "shall have jurisdiction of violations * * * and suits * * * to enforce" language. That very language appears in other contemporaneously-enacted provisions for which no such uniformity focus can be claimed, including ones conferring concurrent jurisdiction and some, such as 15 U.S.C. § 77v(a), that quite unusually prohibit removal from state court of cases that raise only federal law questions.

3. Petitioners' textual argument therefore reduces to assertions that the words of Section 27 *themselves* express a "plain" and "unambiguous" intent to withdraw from state courts power to hear cases seeking relief exclusively under their own laws. This claimed "plain meaning" entirely eluded this Court (and the litigants) in *Pan American*, and in numerous other decisions where Section 27 has been described as conferring jurisdiction of cases "arising under the Exchange Act." See Resp. Br. 38 (collecting cases); *Romero*, 358 U.S. at 379 (observing that judicial "reluctance" to adopt "a broad reading of [a] jurisdictional statute[] * * * must be even more forcefully felt when the expansion is proposed, for the first time, eighty-three years after the jurisdiction has been conferred"). Congress itself described the provision in vanilla terms that gave no hint of any disruptive intent. The Senate Report's final section-by-section summary described Section 27 as establishing that "*[e]nforcement of the act* is confined * * * to United States courts," S. Rep. No. 792, 73rd Cong. 2d. Sess. 23 (1934) (emphasis added), without any mention of the need to seize jurisdiction of state law suits that might call for consideration of an Exchange Act provision or regulation.

In point of fact, petitioners' regime is not especially plausible even as a matter of literal meaning. Congress's grant of "jurisdiction of violations" of the Exchange Act is not naturally, let alone "plainly," Pet. Br. 27, read as divesting state courts of authority to decide cases where a complaint *mentions* that a federal law or regulation was broken (including referencing determinations by another judicial or regulatory body of past violations), but that does not ask the court to grant relief for those violations. See Resp. Br. 20. Section 27's other references to "violation[s]," in its language addressing venue, confirm that natural understanding. Under Section 27, a New Jersey investor seeking to enjoin an Exchange Act violation could not hail the defendant into *Massachusetts* federal court by seeding his complaint with allegations referencing prior "violation[s]" harming Bay State investors. In this case (and many others petitioners would sweep into federal court), proof of *state law* violations is both necessary and sufficient for recovery.

Likewise, the statute's reference to actions "to enforce a duty or liability created by [federal securities law]" does not call to mind a suit whose object is enforcement of duties imposed under *state law*. In fact, that phrase, while a relative rarity in the U.S. Code and the U.S. Reports, had an accepted legal meaning at the time the 1933 and 1934 Acts were passed, one that tracks the historic "creation" test for federal jurisdiction. See *Am. Well Works*, 241 U.S. at 260. State courts nationwide have long held that a suit is one to "enforce[] a liability created by [a statute]" only where the plaintiff's claim owes its existence to that statute. The Arizona Supreme

Court, for example, has held that "[t]he term 'liability created by statute' [means] * * * a liability that comes into being solely by statute" and had "no existence prior to the enactment creating it." *Griffen* v. *Cole*, 131 P.2d 989, 991 (1942). Other decisions are to the same effect: "the test is whether liability would exist absent the statute in question." *Royal Ins. Co.* v. *Roadarmel*, 11 P.3d 105, 108 (Mont. 2000). See *Smith* v. *Cremins*, 308 F.2d 187, 189–190 (9th Cir. 1962) (same, applying California law).[5]

B. Congress Did Not Intend, and Section 27 Does Not State, a "Test" For Exclusive Federal Jurisdiction of State Law Claims

Petitioners' claims to have unearthed a novel jurisdictional "test" (one they pronounce satisfied in this case) is, on closer examination, an assertion that the words in Section 27 *could be* understood (by someone unfamiliar with this Court's jurisdiction precedents and the statutory context) to encompass a case, for example, where the complaint's factual allegations reference defendants' past Exchange Act violations, even though liability would require proof that standards prescribed by state law were violated.

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[5] Indeed, as a compendium of words and phrases attests, cases adopting this canonical formulation could fill the rest of this brief. See 25 Words and Phrases 71-77 (Perm. ed. 2008). See, *e.g.*, *Nimick* v. *Mingo Iron Works Co.*, 25 W. Va. 184, 194 (1884); *Wilson* v. *Guaranteed Sec. Co.*, 272 P. 946, 949 (Utah 1928); *Baldwin* v. *Fenimore*, 89 P. 2d 883 (Kan. 1939); *Hough* v. *Hough*, 242 P.2d 162, 163 (Okla. 1952); *Sheets* v. *Graco, Inc.*, 292 N.W.2d 63, 70 (N.D. 1980); *City of Rexburg* v. *Madison Cnty.*, 964 P.2d 838, 842 (Idaho 1988); *McAuliffe* v. *W. States Imp. Co.*, 651 N.E.2d 957, 960 (Ohio 1995); *Torrealba* v. *Kesmetis*, 178 P.3d 716, 722 (Nev. 2008).

But that same linguistic possibility was present in *Pan American*. The suit held outside exclusive federal jurisdiction there sought to recover from the defendant moneys alleged (and ultimately held) to have been collected "in violation" of the Natural Gas Act. See 366 U.S. at 662, 666. And this indeterminacy arises when attempting to apply petitioners' "test" to the facts in other cases. While petitioners say that statutory "plain language" disables state courts from "even consider[ing]" whether the Exchange Act was violated, Pet. Br. 22, this Court held in *Matsushita* that consideration was not within Section 27's ambit. See 516 U.S. at 385.[6]

Petitioners' claim of an alternative "rule" is undone, to a significant extent, by their efforts to salvage some consistency between their proposal and *Pan American*. They insist (Br. 38) that this Court's decision should be read as "only" endorsing the well-pleaded complaint rule, which they equate with the principle that preemption and other federal law *defenses* do not confer federal jurisdiction.

But as the *Pan American* opinion itself stresses, there is much more to the well-pleaded complaint rule than the proposition that federal defenses are insufficient.[7] The central thrust of the doctrine is

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[6] See also 516 U.S. at 382 & n.7 (describing complaint alleging that defendants wrongly exposed the corporation "to liability under the *federal securities laws*" as one as "asserting purely state law causes of action" for Section 27 purposes) (emphasis added).

[7] *Pan American* was hardly a classic preemption-defense case: The *plaintiffs* invoked federal law, contending that a prior decision holding (federally) unlawful a rate previously paid,

that federal jurisdiction should be determined by the authority under which the plaintiff chooses to seek relief, not by the facts that his complaint alleges: "A plaintiff asserting facts that may invoke either Federal or state jurisdiction may choose to limit the claim to one based solely upon state law and proceed in state court." *Gateway 2000, Inc.* v. *Cyrix Corp.*, 942 F. Supp. 985, 990 (D. N.J. 1996); accord *Beneficial Nat'l Bank* v. *Anderson*, 539 U.S. 1, 12 (2003) (federal jurisdiction may not be sustained even where facts alleged in support of state-law relief "would *only* support a federal claim"). *Pan American* was emphatic on this point, explaining that it was "immaterial * * * that the plaintiff *could have* elected to proceed on a federal ground. *If the plaintiff decides not to invoke a federal right, his claim belongs in a state court.*" 366 U.S. at 663 (emphasis added) (citation omitted); accord, *e.g.*, *The Fair* v. *Kohler Die & Specialty Co.*, 228 U.S. 22, 25 (1913) ("Of course, the party who brings a suit is master to decide what law he will rely upon.").

By jettisoning this integral component of the well-pleaded complaint rule—that the plaintiff, as "master" of the case, "may avoid federal jurisdiction by exclusive reliance on state law," *Beneficial*, 539 U.S. at 12 (quoting *Caterpillar, Inc.* v. *Williams*, 482 U.S. 386, 392 (1987))—petitioners' proposed rule would defeat the well-pleaded complaint doctrine's central purpose of ensuring that threshold jurisdictional determinations are certain and easily made. See *Holmes*, 535 U.S. at 832. The husk of the

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entitled them to a contractual recovery. See 366 U.S. at 660–661.

rule petitioners would retain under Section 27 (out of ostensible fidelity to the *Pan American* precedent) would make no sense. Were Congress as distrustful of "non-expert" state court interpretation as petitioners insist (see Br. 26), it would be exceedingly strange to leave preemption cases, where the meaning of Exchange Act is sometimes "the only question truly at issue," to *state* courts, *Caterpillar*, 482 U.S. at 389, while assigning exclusively to federal tribunals cases that raise no more than the possibility of a disputed federal question.

In fact, the very common preemption-defense fact-pattern highlights that petitioners' regime is neither "simple" nor grounded in any "clear" language in Section 27's text. Under longstanding precedent, the well-pleaded complaint rule controls where the plaintiff anticipates a preemption plea: "[A] federal court does not have original jurisdiction over a case in which the complaint presents a state-law cause of action, but also asserts * * * that a federal defense the defendant may raise is not sufficient to defeat the claim." *Franchise Tax Bd.* v. *Constr. Laborers Vacation Trust*, 463 U.S. 1, 10 (1983) (citations omitted). But on petitioners' account, it would seem "plain" that a complaint's assertion that a defendant did not in fact comply with a concededly preemptive federal enactment (and therefore could not defeat recovery) would be an allegation of "a violation" sufficient to oust a state court of jurisdiction.[8]

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[8] That principle is by no means the only important and familiar jurisdictional rule that petitioners would sweep into limbo. The vitality of the principle that a suit alleging a violation of a state law rule that incorporates or merely parallels a federal

Petitioners nonetheless claim (Br. 34) that their "test" is "simple' and "easily administrable," contrasting it to the "complicated," "multi-factor" *Grable* test. That is plainly not so. Petitioners do not propose to *supplant* the *Grable* test for federal jurisdiction, but rather to *supplement* it. Under their proposal, in cases where an issue under the Exchange Act or its statutory relatives are or might be raised (or might have been), a district court could not remand before having considered all *three* bases for assuming jurisdiction— the canonical "creation" test, the *Grable* balancing test, *and* petitioners' Section 27 "test."

But even in direct comparison, the *Grable* test is much more certain and predictable than is petitioners'. To be sure, there are cases where the expected outcome of the *Grable* balancing is uncertain; but that should not obscure the large number of cases (virtually all cases arising under state law) where the *Grable* rule makes immediately clear that a federal forum is *not* available. Petitioners' untested proposal, in contrast, leaves courts and litigants guessing as to which cases are strong or weak candidates for federal jurisdiction. The text of Section 27 says nothing at all about which black-letter jurisdictional rules still operate and which ones (on petitioners' view) are swept aside, and parties seeking to litigate state law claims in state court would have no idea what facts, circumstances,

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standard—as many state securities laws do—does not raise a federal question, see *NASDAQ OMX Grp., Inc.* v. *UBS Sec., LLC*, 770 F.3d 1010, 1022 n.7 (2d Cir. 2014), would likewise be jeopardized, if, as petitioners suggest, the presence of state law complaint allegations that track a federal rule (or that "nearly" do, Pet. Br. 9) triggered exclusive federal jurisdiction.

or allegations risk triggering exclusive federal jurisdiction. (The only truly unambiguous signal petitioners send is to keep state court complaints as bare-bones as possible.).

C. Other Rules Governing the Interpretation of Jurisdictional Statutes Reinforce the Restrained Construction of Section 27

The *Grable* rule in fact highlights how out of line with the existing "mosaic" of federal jurisdiction rules petitioners' regime would be. *Romero*, 358 U.S. at 379. The *Grable* doctrine, while more cumbersome than the creation test, operates as a safety valve, recognizing that there are particular state law cases where particular federal interests—including Exchange Act interests—support (concurrent) federal jurisdiction. But that doctrine, unlike petitioners' proposed regime, places the burden on the party invoking federal jurisdiction and shows explicit regard for state sovereignty, providing a built-in federalism "veto" even for cases that hinge on resolution of substantial federal questions. *Grable*, 545 U.S. at 313. Petitioners propose to supplement this scalpel approach with a meat-axe rule that places within exclusive federal jurisdiction state law cases with the *weakest* claims of a federal ingredient.

Nor are these the only important ways in which petitioners' proposed rule deviates from "sound judicial policy," *Romero*, 358 U.S. at 379. As noted, the only truly certain consequence of adopting petitioners' proposal is that there would be *less* pleading, a result that would adversely affect securities industry interests, as well as those of investors. Injured investors intent on obtaining state law relief from a state court and on avoiding

protracted jurisdictional litigation would have reason to say as little as possible in their complaints, thereby depriving defendants, state judges, and federal courts deciding removal petitions of important information about what was at stake (and inevitably triggering disputes as to whether diverse "heightened pleading" requirements had been met).

At the same time it would improperly deny those who prefer to litigate in *state* courts the power to make that choice (by foregoing federal relief, see p. 22, *supra*), petitioners' regime would also make it improbably easy for a plaintiff who wanted her case in *federal* court to get there. Petitioners' brief proceeds as if their proposal is relevant only to *defendants* in securities cases; but Section 27, the provision their rule ostensibly implements, concerns original, not removal, jurisdiction. Under their rule, a plaintiff's merely adding Exchange Act allegations that are uncontested or unnecessary to resolving the parties' dispute would entitle her to litigate state law claims in a federal forum. The historic "burden of establishing * * * [federal] jurisdiction," *Kokkonen* v. *Guardian Life Ins. Co.*, 511 U.S. 375, 377 (1994), would be tantamount to pushing on an open door, forcing district courts to fashion entirely new rules for identifying and combatting inappropriate invocations of the newly minted "Section 27" jurisdiction.

Moreover, rules like petitioners' proposal, which broaden the categories of claims subject to exclusive, rather than concurrent, jurisdiction increase the complexity, inefficiency, and potential unfairness of litigation. In *Marrese* v. *American Academy of Orthopaedic Surgeons*, 470 U.S. 373 (1985), for example, the Court was required to decide whether a

state court judgment precluded the plaintiff from pursuing federal antitrust claims that could not have been adjudicated in that first proceeding, ultimately concluding that the federal claims were precluded because they were sufficiently similar to ones actionable under state law. *Id.* at 375–377. Under petitioners' proposal, plaintiffs intent on litigating state claims in a state forum would likely have to maintain separate cases, with all the expense and complexity that such litigation entails. See *Will* v. *Calvert Fire Ins. Co.*, 437 U.S. 655 (1978) (considering appropriateness of staying proceedings when Exchange Act and state law suits are proceeding concurrently). Indeed, this Court's decision in *Matsushita* rejected an expansive understanding of Section 27, in part to mitigate these complexities and enable parties in cases that straddle state and federal courts to reach mutually acceptable settlements. 516 U.S. at 385–386.

Whether or not petitioners' regime would open litigation floodgates, it would significantly expand the number of cases and alter the character of cases that come within federal courts' jurisdiction. Not only would petitioners' rule mean that almost any case involving securities, natural gas, or electricity in which one party or the other desires federal jurisdiction would get to federal court, but the presence of a single (state law) claim that passed petitioners' "test" would trigger supplemental jurisdiction over state law claims "pendant" to that one.

And adopting petitioners' proposal would severely limit state regulators' ability to enforce their States' own securities laws. Many such state laws parallel

their federal counterparts, often reflecting conscious efforts at coordination and almost invariably making compliance easier. But a rule that overrode—or even merely unsettled—the principle that such parallels do not make a state claim federal, see, *e.g.*, *Buethe* v. *Britt Airlines, Inc.*, 749 F.2d 1235, 1238–1239 (7th Cir. 1984)—would embolden respondents in state administrative and enforcement actions, who are rarely in a rush to reach a merits adjudication, to seek removal to federal court in almost every case. That would, by dramatically increasing the time and money that such governmental enforcement actions would consume, hamstring States' ability to enforce their own laws.

State courts are experts in interpreting and applying their own laws, and abstract sovereignty principles aside, a regime that required federal courts to decide cases raising close or difficult state law questions—based on the presence in a complaint of a tangential federal issue—would impair the quality of judicial decision-making and hinder States' ability to promote and control the development of their own legal rules.

III. Section 27, Properly Construed, Both Promotes Greater Interpretive Uniformity and Respects the Exchange Act's Textually-Expressed Preservation of State Authority

Petitioners' most sustained argument for their rule is not from statutory text or precedent or norms governing interpretation of jurisdictional statutes, but rather from "purposes" and "premises" that they ascribe to Section 27 and to the Exchange Act generally. Petitioners highlight that the Act was supported by congressional findings of a compelling

need for national action and then discuss the general efficiency benefits of unitary regulation and uniform interpretation—in the service of an argument that Section 27 should be read in light of an overriding congressional purpose to eliminate even the possibility of diverse interpretation by (non-expert) state judges.

The serious problems with such arguments are well known: "Purposes" are not enacted through the Constitution's law-making process, see *Wyeth* v. *Levine*, 555 U.S. 555, 587 (2009) (Thomas, J., concurring in the judgment), and "no legislation pursues its purposes at all costs." *Rodriguez* v. *United States*, 480 U.S. 522, 525–526 (1987). But the evidence here shows that the purposes and premises petitioners ascribe to Section 27 were not Congress's actual ones.

To begin, although petitioners mix together claims about regulatory non-uniformity—the prospect that an actor might be accountable to 51 different sovereigns—and ones about *interpretive* non-uniformity, *i.e.*, the possibility that the same federal law will be differently applied in different jurisdictions, it is undeniable that Congress intended and expressly approved dual, rather than unitary, securities regulation. The Exchange Act provision immediately next to Section 27 was enacted "to protect * * * state authority," *Leroy* v. *Great W. United Corp.*, 443 U.S. 173, 182 (1979), and to "leave the States with as much leeway to regulate securities transactions as the Supremacy Clause would allow them," *id.* at 182 n.13. It announces that "the rights and remedies [the Act] provided" are "in addition to" those under state law and explicitly affirms "the

jurisdiction of the securities commission * * * of any State." 15 U.S.C. § 77bb(a). See 69A Am. Jur. 2d Securities Regulation–Federal § 999 (2015) (describing this provision as "mak[ing] it absolutely clear that Congress was not preempting the field"). Congress repeatedly has affirmed its view that "State securities regulation is of continuing importance, together with the Federal regulation of securities, to protect investors and promote strong financial markets." Securities Litigation Uniform Standards Act of 1998, Pub. L. 105-353, 112 Stat 3227 § 2(4).

And while the grant of exclusive jurisdiction in Section 27 surely was meant to promote "greater uniformity," *Matsushita*, 516 U.S. at 385, and jump-start development of a body of precedent under a brand-new federal statute, petitioners' suggestions that the 73rd Congress sought to avoid at all costs the possibility that an Exchange Act issue might be considered by a "non-expert" state court judge lack plausibility.

Congress did not even pursue *federal court* uniformity single-mindedly. Section 27 itself includes expansive rules for venue and service of process, see *Leroy*, 443 U.S. at 188 (describing "the underlying policy of § 27 to confer venue in a wide variety of districts in order to ease the task of enforcement of federal securities law[s]"). That regime stands in contrast to ones enacted under statutes where uniform, expert interpretation is manifestly of paramount importance. See, *e.g.*, 28 U.S.C. § 1295 (granting the Federal Circuit exclusive jurisdiction over final decisions in, among others, patent cases); 42 U.S.C. § 7607(b)(1) (judicial review of "any * * * nationally applicable [EPA] regulation[]" may be

pursued only in the D.C. Circuit). See *Tafflin*, 493 U.S. at 465 (recognizing the decisional "inconsistency" that the "multimembered, multi-tiered federal judicial system * * * creates").

Overheated claims of congressional doubts of state court competence cannot be reconciled with the reality that the same Congress expressly *prevented* federal courts from hearing suits under the Securities Act that were first filed in state court, nor with state courts' unchallenged (Pet. Br. 17) authority to adjudicate Exchange Act preemption questions, which entail resolving "highly technical and complex," *id.* 25, often dispositive, Exchange Act questions. Congress rejected complete preemption, as well as field preemption, under the Act. Cf. *Caterpillar*, 482 U.S. at 393; see also *El Paso Natural Gas Co.* v. *Neztsosie*, 526 U.S. 473 (1999) (applying 42 U.S.C. § 2014(hh), which provides for federal court resolution of Price-Anderson Act preemption defenses). Indeed, for all the talk of state courts' "non-expert[ise]," Pet. Br. 25–26, in 1934 many of those tribunals had more experience adjudicating securities disputes than did their federal counterparts. See Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 Tex. L. Rev. 347 (1991) (detailing early-twentieth-century state securities regulation).

And had Congress determined that federal court resolution of every Exchange Act issue were vitally necessary for interpretative uniformity—and that uniformity itself was of transcendent importance—that judgment would have precluded the decision in *Shearson/American Express, Inc.* v. *McMahon*, 482 U.S. 220 (1987), in which the Court recognized that *arbitral* tribunals are "readily capable" of handling

Exchange Act claims, notwithstanding their "factual and legal complexit[y]." *Id.* at 232. Indeed, the most relevant difference between state court and arbitral determination is that state court decisions erroneously interpreting federal law are within federal courts' power to correct. Compare 28 U.S.C. § 1257 and *Tafflin*, 493 U.S. at 464–465 with *McMahon*, 482 U.S. at 231 (discussing *Wilko* v. *Swan*, 346 U.S. 427, 436–437 (1953)). This Court, rejecting exclusive jurisdiction in *Tafflin*, invoked that very "anomal[y]": Arguments "that state courts are incompetent to adjudicate civil RICO suits," the Court explained, lost all force after *McMahon* had rejected that "RICO claims are too complex to be subject to arbitration." 493 U.S. at 466 (quoting 482 U.S. at 239).

To the extent petitioners' arguments ask the Court to presume that state judges are systematically susceptible to "inflammatory" or erroneous arguments where federal law is at issue, Pet. Br. 26, or otherwise cannot be relied upon to "hold the balance nice, clear, and true," *Tumey* v. *Ohio*, 273 U.S. 510, 532 (1927), they not only defy repeated admonitions of this Court, see, *e.g.*, *Moore* v. *Sims*, 442 U.S. 415, 430 (1979), and judgments Congress expressed in the 1934 Act, but they ignore empirical reality. State courts are capable of addressing the issue of federal preemption in complex securities law cases. See, *e.g.*, *BT Sec. Corp.* v. *W.R. Huff Asset Mgmt. Co.*, 891 So.2d 310, 316 (Ala. 2004); *Diamond Multimedia Sys., Inc.* v. *Superior Court*, 968 P.2d 539, 559–560 (Cal. 1999); *Orman* v. *Charles Schwab & Co.*, 688 N.E.2d 620, 626 (Ill. 1997); *Dahl* v. *Charles Schwab & Co.*, 545 N.W.2d 918, 926 (Minn.

1996); *Nanopierce Techs., Inc.* v. *Depository Trust & Clearing Corp.*, 168 P.3d 73, 85 (Nev. 2007); *Guice* v. *Charles Schwab & Co.*, 674 N.E.2d 282, 292 (N.Y. 1996); *Ongstad* v. *Piper Jaffray & Co.*, 755 N.W.2d 877, 878–879 (N.D. 2008). See generally *Gunn* v. *Minton*, 133 S. Ct. 1059, 1067 (2013) ("state courts can be expected to hew closely to * * * pertinent federal precedents").[9]

Almost everything else that needs to be said in answer to petitioners' drumbeat "uniformity" assertions was said by this Court in *Tafflin*, which responded to "predict[ions]" that permitting state courts "to interpret federal criminal statutes" as predicates for federal RICO liability would impair "the orderly and uniform development of federal criminal law." 493 U.S. at 464. While recognizing that the "need for uniformity and consistency" was important and textually expressed, see pp. 11–12,

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[9] If anything, the uniformity concerns that may have animated the grant of exclusive jurisdiction have likely ebbed since 1934. When the Exchange Act was first passed, there was reason for concern that state courts, including in States whose laws had supplied the model for certain of the Act's provisions, might not give the federal enactment independent meaning. But more than eight decades of SEC enforcement and federal jurisprudence, including a robust body of federal preemption case law, surely have dampened concern that state courts would confuse state standards with federal ones, and States themselves have adopted uniform laws, fashioned and modified in light of significant developments under federal statutes. See Uniform Law Commission, *Securities Act Summary*, available at http://www.uniformlaws.org/ActSummary.aspx?title=Securities%20Act (explaining that Uniform Securities Act, promulgated in 1956, has been adopted by 37 jurisdictions, including New Jersey).

supra (discussing 18 U.S.C. § 3231)—the Court concluded "that state court adjudication of civil RICO actions will, in practice, have at most a negligible effect on * * * uniform interpretation," noting, *inter alia*, that federal courts "would not be bound by state court interpretations of the federal offenses constituting RICO's predicate acts," while state courts would "be guided by federal court interpretations" and subject to correction on review. See 493 U.S. at 464–465. Accord *Pan American*, 366 U.S. at 665–66 (highlighting that exclusive jurisdiction is not the only means for securing adequate uniformity).

CONCLUSION

The text of Section 27, read according to the rules governing the interpretation of jurisdictional statutes, establishes that Congress did not sweep away fundamental, settled rules allocating responsibility between federal and state courts. Rather, the provision ensured that every cause of action created by the Exchange Act—be it civil or criminal, brought by a government agency or private party, for an affirmative violation of a rule or a failure to comply with a duty—would be litigated in federal court, regardless of the amount in controversy. But Congress did not divest state courts of their jurisdiction over state law violations. This case, which seeks only to enforce duties created by New Jersey law, belongs in the courts of that State.

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

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Supreme Court, U.S.
FILED
OCT 30 2015
OFFICE OF THE CLERK

No. 14-1132

In The Supreme Court Of The United States

MERRILL LYNCH, PIERCE, FENNER & SMITH, INCORPORATED; KNIGHT CAPITAL AMERICAS L.P., FORMERLY KNOWN AS KNIGHT EQUITY MARKETS L.P.; UBS SECURITIES LLC; E*TRADE CAPITAL MARKETS LLC; NATIONAL FINANCIAL SERVICES LLC; AND CITADEL DERIVATIVES GROUP LLC,

Petitioners,

v.

GREG MANNING; CLAES ARNRUP; POSILJONEN AB; POSILJONEN AS; SVEABORG HANDEL AS; FLYGEXPO AB; AND LONDRINA HOLDING LTD.,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF OF AARP AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

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STATEMENT OF INTEREST[1]

AARP is a nonpartisan, nonprofit organization with a membership that helps people turn their dreams into real possibilities, strengthens communities, and fights for issues that matter most to families such as employment, healthcare, income security, retirement planning, affordable utilities and protection from financial abuse. Through education, advocacy, and service, and by promoting independence, dignity, and purpose, AARP seeks to enhance the quality of life for all. As one method of promoting independence, AARP attempts to foster the economic security of individuals as they age by seeking to increase the availability, security, equity, and adequacy of public and private retirement plans. In this regard, AARP has a longstanding interest in the operation of the securities markets because of the critical role they play in helping ensure financial security in retirement. AARP is greatly concerned about fraudulent, deceptive, and unfair business practices that can disproportionately harm older people, as well as the rights of older workers. AARP submits comments on legislative and regulatory proposals that address investment fraud, files amicus briefs in cases involving the securities laws, and opposes legislative efforts to limit the remedies of defrauded investors.

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[1] In accordance with this Court's Rule 37.6, no counsel for a party wrote this brief in whole or in part, and no person other than amicus curiae or its counsel made a monetary contribution intended to fund the brief. The parties have filed blanket waivers consenting to the filing of amicus briefs.

SUMMARY OF ARGUMENT

The decreased ability of retirees to rely on Social Security to replace wages has led more individuals to enter the securities markets, either on their own or through an employer-sponsored defined contribution plan. The unfortunate prevalence of fraud in the marketplace requires that investors have the benefit of a full range of strong, flexible legal enforcement tools including state court remedies. Federal law does not preempt the states' historic police powers in such fields as consumer and investor protection. Private remedies under state law provide vital protection for investors not available under federal law. The respective state law claims at issue in this case were enacted to protect investors, and exist in harmony with federal securities law to achieve that same purpose. State laws are a critical element available to investors to police the securities marketplace.

ARGUMENT

I. SECURITIES EXCHANGE ACT SECTION 28 PRESERVES STATE LAW CLAIMS.

"Congress has expressly preserved the role of the states in securities regulation" and "[s]tate securities laws [continue to] exist in every state, the District of Columbia and Puerto Rico . . . . " *Baker, Watts & Co. v. Miles & Stockbridge*, 876 F.2d 1101, 1107 (4th Cir. 1989). States "may provide additional rights and remedies which do not conflict with federal securities law." *Id.* (citing *Underhill Assocs.*,

Inc. v. Bradshaw, 674 F.2d 293, 295-96 (4th Cir. 1982)). The legislative history and express language of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78a *et seq.*, show that a basic intent of the statute was the protection of the investing public through the "maintenance of fair and honest markets." 15 U.S.C. § 78b. In enacting the Exchange Act, Congress did not intend to cut off state law remedies. Section 28 of the Exchange Act (15 U.S.C. § 78bb) provides in relevant part that the rights provided by the Act are "in addition to any and all other rights and remedies that may exist at law or in equity."[2] Section 28 of the Exchange Act indicates that Congress contemplated and intended that persons with claims under other laws should be able to pursue those claims. "Congress plainly contemplated the possibility of dual litigation in state and federal courts relating to securities transaction." *Matsushita Elec. Indus. Co. v. Epstein*, 516 U.S. 367,

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[2] Specifically Section 28 provides:

> (a)(1) Except as otherwise specifically provided in this title, nothing in this title [15 U.S.C. §§ 78a *et seq.*] shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this title [15 USC §§ 78a *et seq.*] or the rules and regulations under this title [15 U.S.C. §§ 78a *et seq.*].
>
> (a)(2) Rule of construction. Except as provided in subsection (f), the rights and remedies provided by this title [15 U.S.C. §§ 78a *et seq.*] shall be in addition to any and all other rights and remedies that may exist at law or in equity.

383 (1996). If Congress had intended all federal and state claims relating in any way to securities to be the subject of exclusive jurisdiction of the federal courts, it could have so provided. It did not.

Petitioners' arguments that federal courts have exclusive jurisdiction of violations of the Exchange Act ignores Congress's express purpose in enacting the federal securities laws, which was to supplement – rather than supplant—state laws and remedies. *Zuri-Invest AG v. Natwest Fin. Inc.*, 177 F.Supp.2d 189, 191 (S.D.N.Y.2001). States retain the ability to protect investors through application of state anti-fraud laws under the express language of 15 U.S.C. § 77r (c)(1). *See also SEC v. Nat'l Sec., Inc.*, 393 U.S. 453, 461 (1969).

In *Leroy v. Great Western United Corp.*, 443 U.S. 173 (1979)[3], this Court noted that "Thomas Corcoran, a principal draftsman of the [Securities Exchange Act of 1934], indicated to Congress that the purpose of § 28(a) was to leave the States with as much leeway to regulate securities transaction as the Supremacy Clause would allow them in the absence of such a provision." *Id.* at 182 n. 13 (citations omitted). *See also Hall v. Geiger-Jones Co.*, 242 U.S. 539, 550 (1917).

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[3] *Superseded by statute on other grounds in* 28 U.S.C. § 1391(b)(2).

II. PRIVATE REMEDIES UNDER STATE LAW PROVIDE VITAL PROTECTION FOR INVESTORS NOT AVAILABLE UNDER FEDERAL LAW.

Allowing defrauded investors to assert their own private rights of action is "an indispensable tool . . . [and is] crucial to [maintaining] the integrity of domestic capital markets." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 321 n.4 (2007) (quoting *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 81 (2006)). Today, both state and federal laws regulate the purchase and sale of securities. However, state law came long before federal law and the right of investors to sue has long been a critical component of state regulation of securities.[4] As part of their enforcement scheme, state securities regulators rely heavily upon plaintiffs acting as private attorneys general, often with the benefit of fee shifting statutes, to enhance enforcement and ferret out fraud. Private plaintiffs provide states with an efficient means of increasing enforcement without increasing the size of government staffs or straining public finances.

As one commentator observes:

> "[T]he civil recovery provisions of the state securities acts serve an

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[4] Jonathan R. Macy & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 Tex. L. Rev. 347, 348 (1991) (States almost exclusively regulated securities sales through specialized "blue sky" statutes for "more than a generation" before Securities Act of 1933).

> important *public* function in the enforcement of these acts. The state securities agencies and criminal prosecutors simply have neither the staff nor the funds to fully enforce the acts. As a result, the investor bringing a civil recovery serves as a private attorney general. Therefore, such actions are to be encouraged."

Joseph C. Long, *12A Blue Sky Law* § 9:151.27 (2015) (original emphasis).

Congress has also recognized that "[p]rivate securities litigation is an indispensable tool with which defrauded investors can recover their losses without having to rely upon government action."[5] Additionally, "private lawsuits promote public and global confidence in our capital markets and help to deter wrongdoing and to guarantee that corporate officers, auditors, directors, lawyers and others properly perform their jobs."[6]

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[5] H.R. Conf. Rep. No. 104-369, at 31 (1995); *see also* Francis J. Facciolo & Richard L. Stone, *Avoiding the Inevitable: The Continuing Viability of State Law Claims in the Face of Primary Jurisdiction and Preemption Challenges Under the Securities Exchange Act of 1934*, 1995 Colum. Bus. L. Rev. 525, 543-46 (1995) ("Section 28(a)) has been used by courts to establish the principle that the Exchange Act, whatever it may say about preemption with respect to any particular area of securities regulation, has not displaced state law in general with respect to either corporate law or securities fraud, *i.e.*, there has been no field preemption.")(footnotes omitted).

[6] H.R. Conf. Rep., *supra* note 5, at 31.

State law-based private securities litigation can provide remedies for financial wrongs not available under federal securities statutes. As an example, broker-dealers are generally not subject to a fiduciary duty under the current *federal* securities laws.[7] Congress likewise in enacting securities laws did not intend to provide a broad federal court remedy for all fraud. *See Santa Fe Indus. v. Green*, 430 U.S. 462, 479-80 (1977). In *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148 (2008), this Court repeated its caution against letting the federal securities laws interfere with the well "functioning and effective state-law guarantees" which may not be provided for under federal law. *Id.* at 161.

This Court should construe Section 27 in accordance with Section 28 so that the Exchange Act does not preclude important state law rights and remedies when doing so would not serve the purpose

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[7] Staff of SEC, *Study on Investment Advisors and Broker-Dealers*, SEC Study 54 (Jan. 2011) (emphasis added), http://sec.gov/news/studies/2011/913studyfinal.pdf. In Spring 2015, the Employee Benefits Security Administration ("EBSA") and its parent agency, the Department of Labor ("DOL"), submitted a proposed regulation titled "EBSA-2010-0050" or "RIN 1210-AB32" as an effort to "amend[ ] the regulatory definition of the term 'fiduciary' set forth at 29 CFR 2510.3-21(c) to more broadly define as fiduciaries those persons who render investment advice to plans and IRAs for a fee . . . ." Dep't of Labor, *Current Unified Agenda of Regulatory and Deregulatory Actions RIN: 1210-AB32*, Office of Information and Regulatory Affairs, http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201504&RIN=1210-AB32 (last visited Sept. 29, 2015).

of the statute. Since not every instance of financial unfairness or breach of fiduciary duty will constitute a fraudulent activity under § 10(b) or Rule 10b-5, the Court should be wary of foreclosing common law remedies which supplement existing federal statutes. *Gochnauer v. A.G. Edwards & Sons, Inc.*, 810 F.2d 1042, 1049 (11th Cir. 1987).

A. The Amended Complaint Seeks Only State Law Relief.

The operative complaint ("Amended Complaint") seeks relief exclusively under the statutory and common law of New Jersey to recover damages "as a result of Defendants' massive manipulation of the market for the price of the common stock of Escala Group". Am. Compl., attached as App. D to Pet. for Writ of Certiorari at 43a, *Manning et al., v. Merrill Lynch, et al.* "Market manipulation harms the integrity of, and thereby undermines public confidence in, securities and derivatives markets by distorting prices . . . and creating an artificial appearance of market activity." Technical Committee, IOSCO, *Investigating and Prosecuting Market Manipulation*, IOSCO Rep. 2 (May 2000), http://bit.ly/1GokTgI. Public confidence in the fairness of securities markets enhances their liquidity and efficiency. *Id.*[8]

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[8] Market manipulation is also prohibited for wholesale electricity markets under Section 222 of the Federal Power Act [16 U.S.C. § 824v] and wholesale natural gas markets under Section 4A of the Natural Gas Act. [15 U.S.C § 717c-1]. As this Court recently reaffirmed: "the Natural Gas Act 'was drawn with meticulous regard for the continued exercise of state

The Amended Complaint specifically alleges that defendants manipulated the price of stock by manufacturing "fictitious and unauthorized phantom shares". (Am. Compl. ¶ 4). The Amended Complaint acknowledges that the allegations of market manipulation constitute violations of both state and federal law. Rule 10b-5 specifically prohibits fraud and misrepresentation in connection with the purchase or sale of any security. *See* 17 C.F.R. § 240.10b-5. Additionally, the Amended Complaint includes allegations that could constitute a violation of SEC rules regulating the practice of short selling stock.[9]

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power, not to handicap or dilute it in any way.' *Panhandle Eastern Pipe Line Co. v. Public Serv. Comm'n of Ind.*, 332 U. S. 507, 517-518, 68 S. Ct. 190, 92 L. Ed. 128 (1947); see also *Northwest Central*, 489 U. S., at 511, 109 S. Ct. 1262, 103 L. Ed. 2d 509 (the "legislative history of the [Act] is replete with assurances that the Act 'takes nothing from the State [regulatory] commissions'" (quoting 81 Cong. Rec. 6721 (1937))." *Oneok, Inc. v. Learjet, Inc.*, 135 S. Ct. 1591, 1599 (2015).

[9] A "short sale" is "a sale of a security that the seller does not own" or a sale that "is consummated by the delivery of a security borrowed by or on behalf of the seller." "Naked" Short Selling Antifraud Rule, SEC Release No. 34-58774, 73 Fed.Reg. 61,666, 61,667 (Oct. 17, 2008); *see also* 17 C.F.R. 242.203(b). While there is no specific private right of action to remedy a violation of SEC rules regarding the short selling of stock, "abusive 'naked' short selling as part of a manipulative scheme," can be maintained because such schemes are "always illegal under the general antifraud provisions of the federal securities laws . . . " "Naked" Short Selling Antifraud Rule, 73 Fed. Reg. at 61,667.

Notably, the Amended Complaint, however, does not assert a federal cause of action. *See* Pet.App. 82a-101a (Am. Compl.¶ 88-161). The Amended Complaint contains ten causes of action detailing violations of New Jersey law including common law theft and fraud.

Petitioners emphasize the allegations in the Amended Complaint that reflect violations of the Exchange Act and its rules and regulations (Pet.Br. 20-21) but completely ignore the state claims apparently hoping that these claims will magically disappear if removed to federal court. Neither the Exchange Act, nor any Commission rule or regulation, purports to displace state law. "To the contrary, in the Act Congress several times indicated its intention that state law should apply where the Act does not." Brief for U.S. as Amicus Curiae Supporting Respondents at 10, *Lynch v. Ware*, 414 U.S. 117 (1973) (No. 72-312), 1973 WL 173812 (citing 15 U.S.C. § 78bb(a)).

Additionally, federal courts are courts of limited jurisdiction. *Kokkonen v. Guardian Life Ins. Co. of Am.*, 511 U.S. 375, 377 (1994). As a result, removal statutes are to be strictly construed, with all doubts resolved in favor of remand. *See, e.g., Abels v. State Farm Fire & Cas. Co.*, 770 F.2d 26, 29 (3d Cir. 1985). The Third Circuit in this case correctly held that federal-question jurisdiction was lacking based on a complaint grounded in state law claims. *Manning v. Merrill Lynch Pierce Fenner & Smith Inc.*, 772 F.3d 158, 163-64 (3d Circ. 2014) (citing *Christianson v. Colt Indus. Operating Corp.*, 486 U.S.

800, 810 (1988) ("[A] claim supported by alternative theories in the complaint may not form the basis for [federal] jurisdiction unless [federal] law is essential to each.").

III. COMPLEX SECURITIES CREATE CONSIDERABLE CHALLENGES FOR INVESTORS.

A. An Increasing Number of Individuals Must Rely on Securities for A Secure Retirement.

The number of investors owning individual stocks and mutual funds has grown enormously in the last several decades. The decreased ability of retirees to rely on Social Security to replace wages has led more individuals to enter the securities markets and unfortunately many older investors are targeted for fraud. This era in the investment arena presents an unusually difficult environment for the individual investors who shoulder the primary responsibility for making appropriate investment choices to assure adequate income to fund their retirement years. According to the latest public data available from the Investment Company Institute (ICI), more than fifty-three million U.S. households, or about forty-three percent, owned mutual funds in 2014. Daniel Schrass & Michael Bogdan, *Profile of Mutual Fund Shareholders, 2014*, ICI Research Report 5 (Feb. 2015).[10] The median age of

[10] https://www.ici.org/pdf/rpt_15_profiles.pdf.

individuals heading households that owned mutual funds was 51. *Id.* at 9.

Although self-reported stock ownership has trended downward since 2007, when sixty-five percent of Americans owned stock, more than half of adult Americans still continue to rely on the stock market to help fund their retirement. *Id.* A recent ICI survey of the mutual fund industry showed that the combined assets of the nation's mutual funds totaled $15.9 trillion, approximately 89 percent of which was held by individuals (as opposed to financial institutions, nonprofits, and other institutional investors). ICI, *2015 Investment Company Fact Book* 29 (55th Ed. 2015), https://www.ici.org/pdf/2015_factbook.pdf.

In the years to come, Social Security is projected to provide proportionately less retirement income as a percentage of prior earnings compared to its role in earlier times. Alicia H. Munnell, *The Declining Role of Social Security*, B.C. Ctr. for Retirement Res. No. JTF6 1 (Feb. 2003)[11] http://papers.ssrn.com/sol3/papers.cfm?abstract_id=556792 (reporting that this replacement rate will continue to drop from 41.2% for a "medium earner" who retired at sixty-five in 2000 to 36.5% by 2030; *see also* Barbara A. Butrica et al., *This Is Not Your Parents' Retirement: Comparing Retirement Income Across Generations*, 72 SSA Bull. No. 1, 37 (2012)[12] ("[B]ecause postretirement incomes are not expected

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[11] http://papers.ssrn.com/sol3/papers.cfm?abstract_id=556792.

[12] http://www.ssa.gov/policy/docs/ssb/v72n1/ssb-v72n1.pdf.

to rise as much as preretirement incomes, baby boomers and GenXers are less likely to have enough postretirement income to maintain their preretirement standard of living compared with current retirees.". At the same time, relatively few private sector employers provide traditional defined benefit pension plans, and more employees rely on defined contribution plans. Barbara A. Butrica et al., *The Disappearing Defined Benefit Pension and Its Potential Impact on the Retirement Incomes of Baby Boomers*, 69 SSA Bull. No. 3, 1 (2009).[13]

B. Fraud Remains an Enormous Problem for Older Investors.

State laws and state securities regulators are a critical element of the institutional arsenal available to police the marketplace. *See, e.g., Not Born Yesterday: How Seniors Can Stop Investment Fraud: Hearing Before Sen. Special Comm. on Aging*, 109th Cong. 21 (2006) (statement of Patricia D. Struck, former Pres. of N. Am. Sec. Admin. Ass'n & Wis. Sec. Div. Admin.).[14]

As former Senator Kohl confirmed:

> "[M]any seniors are turning to investments to increase their retirement income . . . [and] are proving too easy prey for con artists ready to steal their hard earned

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[13] http://www.ssa.gov/policy/docs/ssb/v69n3/v69n3p1.pdf.

[14] http://www.aging.senate.gov/imo/media/doc/3292006.pdf.

> and harder to replace money. . . Regardless of the scam, the outcome remains the same: seniors lose their irreplaceable retirement income."

Not Born Yesterday: How Seniors Can Stop Investment Fraud: Hearing Before Sen. Special Com. on Aging, 109th Cong. 1 (2006) (opening statement Sen. Kohl).[15]

While the character and harmful market effects of market manipulation are well known, the incentives, means and opportunities for carrying out manipulative schemes continue to evolve as developments in technology have created new opportunities for market manipulation.[16] Never have state enforcement actions been more essential to the protection of older investment fraud victims. State laws are a critical element of the institutional arsenal available to police the marketplace. In enacting the Exchange Act, Congress did not intend to cut off state law remedies. 15 U.S.C. § 78bb.

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[15] http:// www.aging.senate.gov/imo/media/doc/3292006.pdf.

[16] IOSCO, *Addendum to IOSCO Report on Investigating and Prosecuting Market Manipulation*, IOSCO Rep. 1 (2013), http://bit.ly/1Pysuw6.

CONCLUSION

For the foregoing reasons, the decision of the Third Circuit should be affirmed.

Respectfully submitted,

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Supreme Court, U.S.
FILED
NOV 23 2015
OFFICE OF THE CLERK

No. 14-1132

IN THE

Supreme Court of the United States

MERRILL LYNCH, PIERCE, FENNER & SMITH, INCORPORATED; KNIGHT CAPITAL AMERICAS L.P., FORMERLY KNOWN AS KNIGHT EQUITY MARKETS L.P.; UBS SECURITIES LLC; E*TRADE CAPITAL MARKETS LLC; NATIONAL FINANCIAL SERVICES LLC; AND CITADEL DERIVATIVES GROUP LLC, N/K/A CITADEL SECURITIES LLC,
Petitioners,

v.

GREG MANNING; CLAES ARNRUP; POSILJONEN AB; POSILJONEN AS; SVEABORG HANDEL AS; FLYGEXPO AB; AND LONDRINA HOLDING LTD.,
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REPLY BRIEF FOR PETITIONERS

Section 27 of the Exchange Act establishes a specific rule of jurisdiction applicable in only a narrow category of cases: jurisdiction is proper if, but only if, the complaint seeks "to enforce any ... duty created by" the Exchange Act or its regulations. 15 U.S.C. § 78aa(a).[1] That language pointedly does not say that jurisdiction exists only when the suit asserts a *cause of action* created by the Act or its regulations. The question is whether the suit, whatever the source of its cause(s) of action, seeks to enforce a *duty* created by the Act or its regulations. If it does, a judicial judgment about the asserted Exchange Act duty obviously is more than just a "mere possibility," as respondents wrongly assert—it is exactly what the plaintiff seeks.

And it is exactly what respondents seek here. Their complaint asserts state-law causes of action based on alleged "illegal short selling" of Escala stock, which the complaint explicitly *defines* as short selling *in violation of duties prescribed by Exchange*

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[1] Section 27 also reaches suits alleging "violations of" the Exchange Act. 15 U.S.C. § 78aa(a). Respondents contend that "violations" refers only to criminal prosecutions or SEC enforcement actions. Resp. Br. 28. But § 27's venue provision refers to "[a]ny *suit or action* ... to enjoin any *violation* of" the Act, which necessarily encompasses private civil actions. 15 U.S.C. § 78aa(a) (emphasis added). The "violations" language simply makes clear that § 27 *also* applies to criminal prosecutions and administrative enforcement actions. Because there is no substantive difference in this context between private suits seeking to remedy Exchange Act violations and suits seeking to enforce Exchange Act duties, this brief focuses on the "duty" language.

Act Regulation SHO. The complaint thus seeks a judicial determination that petitioners breached Regulation SHO duties as grounds for recovering under state law. It accordingly falls well within § 27's narrow compass.

Largely ignoring § 27's text in favor of abstract generalities about federal jurisdiction, respondents assert that § 27 is not satisfied here because proving the breaches of Regulation SHO duties they pervasively allege would not be strictly *necessary* to establish state-law liability. While that point might suffice to defeat federal-question jurisdiction under 28 U.S.C. § 1331, there is no comparable necessity requirement in § 27's text or implicit in its purpose. The statute instead means just what it says: federal courts, and only federal courts, may adjudicate suits brought to enforce duties created by the Exchange Act or its regulations, even if the plaintiff might theoretically prevail on independent state-law grounds. The decision below should be reversed.

ARGUMENT

Respondents make no effort to defend the Third Circuit's holding that § 27 is not itself a grant of jurisdiction. Pet. App. 22a. They instead assert two conflicting theories of § 27's meaning. One is that § 27 jurisdiction is limited to suits asserting causes of action created by the Exchange Act itself and thus is *narrower* than § 1331 jurisdiction. The other is that § 27 is *identical* to § 1331 jurisdiction, because jurisdiction attaches only when adjudicating the alleged Exchange Act duty would be *necessary* to disposition of a state-law cause of action. These differing interpretations share a common feature—they

are both unconnected to the specific language of § 27, which establishes a particular jurisdictional rule covering "all suits ... brought to enforce any ... duty created by" the Exchange Act or its regulations. 15 U.S.C. § 78aa(a). That rule is easily satisfied by the allegations in respondents' complaint.

A. Section 27 Jurisdiction Is Not Limited To Causes Of Action Created By The Exchange Act

1. Respondents first argue that § 27 applies only to suits asserting causes of action under the Exchange Act itself and therefore can never apply to suits asserting only state-law causes of action. Resp. Br. 31-33. Respondents' amicus Public Citizen similarly describes § 27 as adopting "the Holmesian view" of federal-question jurisdiction, which reflected Justice Holmes' argument that such jurisdiction should be restricted to "suits arising 'under the law that creates the cause of action.'" Public Citizen Br. 11 (quoting *Am. Well Works Co. v. Layne & Bowler Co.*, 241 U.S. 257, 260 (1916)).

That construction contradicts the provision's plain text. If Congress had intended to limit § 27 jurisdiction to suits asserting Exchange Act causes of action, it would have simply granted jurisdiction over "suits asserting causes of action created by the Exchange Act." The language Congress actually used is decidedly different: federal courts have jurisdiction over "all suits ... brought to enforce any ... *duty* created by [the Exchange Act] or the *rules and regulations* thereunder." 15 U.S.C. § 78aa(a) (emphasis added). The underscored language precludes respondents' effort to equate "duty" with "cause of

action." First, the concepts are not synonymous—legal duties are enforced *through* causes of action. *See Moore v. Chesapeake & O. Ry. Co.*, 291 U.S. 205, 215 (1934) (describing action in which federal statute "prescribe[d] the duty" but "breach of duty" was "enforced" through state-law action).[2] Second, § 27 applies equally to duties created by "rules and regulations" promulgated under the Exchange Act, even though a regulation "may not create a right [of action] that Congress has not." *Alexander v. Sandoval*, 532 U.S. 275, 291 (2001). Section 27 thus clearly *rejects* the Holmesian view of jurisdiction.

Respondents nevertheless insist that the Holmesian view is "the most natural reading" of § 27's text, because a "suit asserting claims under state law, invoking state-created rights and remedies, is not a suit brought to enforce federal law." Resp. Br. 31 (alterations omitted). But § 27 jurisdiction does not depend on the "rights and remedies" at issue in the suit—it is based solely on whether the suit seeks to "enforce a *duty*" created by the Act or its regulations.

Respondents' emphasis on "rights and remedies" (Resp. Br. 31, 42) conflates § 27, which includes no such phrase, with Exchange Act § 28, 15 U.S.C. § 78bb(a)(2), which provides that Exchange Act "rights and remedies ... shall be in addition to any and all other rights and remedies that may exist at law or in equity." The latter provision does not ad-

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[2] For example, ERISA § 404(a) prescribes a fiduciary's duties, 29 U.S.C. § 1104(a), while § 409 establishes liability for breach of those duties, *id.* § 1109, and § 502(a)(2) establishes the cause of action to enforce them, *id.* § 1132(a)(2).

dress *jurisdiction*, but *preemption*, providing that states may establish certain substantive rights and remedies beyond those established under the Exchange Act. And § 27 simply requires that suits invoking such remedies be heard in federal court if they seek to enforce Exchange Act duties.[3]

2. Respondents also misread a footnote in *Matsushita Electric Industrial Co. v. Epstein*, 516 U.S. 367 (1996), as holding that § 27 categorically excludes state causes of action, even if they are based on an alleged breach of an Exchange Act duty. Resp. Br. 33-35. The footnote says no such thing.

In *Matsushita*, shareholders of MCA, Inc., sued Matsushita in federal court, alleging that Matsushita's tender offer for MCA shares violated SEC Exchange Act rules addressed only to the conduct of bidders (Matsushita), not targets (MCA). *See* 516 U.S. at 370 (citing 17 C.F.R. §§ 240.14d–10, 240.10b–13 (1994)). In a separate Delaware state-court action, MCA shareholders also sued MCA's directors under state law alleging, inter alia, that their acceptance of the tender offer to become part of Matsushita "wasted corporate assets" by exposing those assets to Matsushita's Exchange Act liabilities. *Id.*; *see Epstein v. MCA, Inc.*, 50 F.3d 644, 660 (9th Cir. 1995). This Court observed in a footnote that § 27 did not apply because the "cause pled was ... a state

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[3] If anything, § 28 *undermines* respondents' argument, because it demonstrates that Congress appreciated the difference between "rights and remedies," on the one hand, and "duties" on the other. If Congress had limited § 27 jurisdiction to suits asserting "rights and remedies created by the Exchange Act," this would be a very different case.

common-law action for breach of fiduciary duty," 516 U.S. at 382 n.7—an action that could not be based on the MCA directors' breach of Exchange Act duties, because the Exchange Act imposed no duties on those directors. Unlike here, in other words, the Delaware complaint in *Matsushita* did not seek to enforce *Exchange Act duties* against the defendants.

The *Matsushita* footnote thus does not establish that state-law causes of action are categorically excluded from § 27. And *Matsushita* otherwise confirms that § 27 *is* implicated when a state court is asked to resolve Exchange Act questions, creating a "danger that state court judges who are not fully expert in federal securities law will say definitively what the Exchange Act means and enforce legal liabilities and duties thereunder." *Id.* at 383. The complaint here asks New Jersey courts to do exactly that, which is why it triggers § 27 jurisdiction.

B. Section 27 Is Not Coextensive With § 1331 "Arising Under" Jurisdiction

Respondents' next argument is that § 27 jurisdiction is coextensive with § 1331 because, in their view, § 27 is triggered only when a state-law claim "*necessarily* turns on federal law." Resp. Br. 46; *see Grable & Sons Metal Prods., Inc. v. Darue Eng'g & Mfr'g*, 545 U.S. 308, 314 (2005) (§ 1331 jurisdiction over state-law claim triggered only if claim necessarily requires resolution of federal issue). But by establishing jurisdiction over suits "*brought* to enforce" Exchange Act duties, § 27's language focuses on what the plaintiff *asks* the court to do, not on what the cause of action would *require* the court to

do. The latter inquiry has been read into § 1331 for policy reasons that do not apply to § 27.

1. To construe § 27, respondents rely heavily on rules established in construing § 1331 jurisdiction. But if Congress had intended § 27 to establish only traditional "arising under" jurisdiction, it would have used the same "arising under" language Congress used in many other jurisdictional provisions. Petr. Br. 37-38. Congress conspicuously rejected that formulation in § 27 in favor of a more precise jurisdictional test. Respondents are correct to say that "Congress legislates against the backdrop of traditional jurisdictional principles, and it presumably intends to invoke those traditional principles *unless it affirmatively says otherwise.*" Resp. Br. 40 (emphasis added). But respondents ignore their own caveat: Congress here *did* "affirmatively say[] otherwise" by using language different from the "traditional" "arising under" formulation.

Respondents make no effort to explain why Congress would use completely different language to mean exactly the same thing.[4] They instead rely on

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[4] Public Citizen speculates that § 27 was intended in part to grant federal jurisdiction without the amount-in-controversy requirement that § 1331 included at the time. Public Citizen Br. 10. But Congress did not need any special provision to accomplish that goal. When the Exchange Act was enacted, there was already a separate statute—28 U.S.C. § 41(8) (1934), now codified as 28 U.S.C. § 1337—establishing federal jurisdiction over "'all suits and proceedings arising under *any law regulating commerce*,' irrespective of the amount involved." *Peyton v. Ry. Express Agency*, 316 U.S. 350, 351 (1942) (quoting 28 U.S.C. § 41(8)) (emphasis added). The Exchange Act is a "law regulating commerce," as its preamble expressly states, 15

statements in opinions from the Court and individual Justices that have described § 27 "*in passing*" as "a traditional 'arising under' jurisdictional grant." Resp. Br. 37 (emphasis added). These concededly offhand references do not establish controlling constructions of § 27. And the fact that opinions addressing other issues occasionally have employed familiar shorthand when precision was unnecessary hardly establishes that § 27 can be "naturally read" to say something it does not.[5]

The language of § 27 is explained by a problem this Court addressed in *Moore* several months before passage of the Act. The plaintiff in *Moore* asserted a state-law statutory negligence cause of action, but alleged a "breach of the duty imposed by" the federal Safety Appliance Acts ("SAA") to establish the alleged negligence. 291 U.S. at 214. This Court held that "although violation of the [SAA] is involved," the action did not "arise under" the SAA within the

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U.S.C. § 78b, and thus no additional jurisdictional provision would have been needed to encompass Exchange Act cases below § 1331's monetary threshold. The different language of § 27 establishes that Congress intended something *different from* the already-existing "arising under" formulation used in § 1331 and § 1337.

[5] Respondents also cite footnoted dicta in *Pan American Petroleum Corp. v. Superior Court*, 366 U.S. 656 (1961), construing the similarly worded § 22 of the Natural Gas Act ("NGA"). But respondents admit that the question presented here was not presented in *Pan Am*, which held only that the well-pleaded complaint rule applies under the NGA. Resp. Br. 39; *see* Petr. Br. 32-33. The footnote on which respondents rely simply states that the language of § 22 does not preclude application of the well-pleaded complaint rule. 366 U.S. 665 n.2.

meaning of § 1331's predecessor, because the cause of action itself remained fundamentally state-law in character. *Id.* at 216. Section 27 avoids that problem by replacing the traditional "arising under" formulation with the "brought to enforce ... any duty" language, thereby ensuring federal jurisdiction over state-law suits that allege violation of Exchange Act duties as a basis for recovery.

In any event, even if respondents were right that § 27 is "naturally read" to confer jurisdiction over any claim "arising under" the Exchange Act, it would not help them, because that expansive term is *naturally* read to include "all cases in which a federal question is 'an ingredient' of the action." *Merrell Dow Pharm. Inc. v. Thompson*, 478 U.S. 804, 807 (1986) (quoting *Osborn v. Bank of the United States*, 22 U.S. (9 Wheat.) 738, 823 (1824)). And there is no dispute that federal jurisdiction would exist here under that construction of "arising under" jurisdiction.

But this Court has never read § 1331 "naturally." It has instead "construed the statutory grant of federal-question jurisdiction as conferring a more limited power," *id.*, for policy reasons specific to § 1331. The main concern is that a natural reading of § 1331 would overrun federal courts with cases that could just as easily be handled by state courts. Petr. Br. 35-36. There is no comparable policy reason to impose such artificial narrowing on § 27. Unlike § 1331, § 27 is *already* limited to a very narrow category of cases: suits brought to enforce the defendant's alleged Exchange Act duties. That language excludes a case in which the Exchange Act duty

arises only by way of defense, because that suit would not be *brought to enforce* the duty. The statutory language likewise precludes jurisdiction over the cases feared by Justice Cardozo, where the Exchange Act issue is merely "lurking in the background." *Gully v. First Nat'l Bank*, 299 U.S. 109, 117 (1936).

Under § 27's plain text, federal jurisdiction is triggered by a state-law claim only where a plaintiff chooses to *allege an Exchange Act duty-breach as a basis for liability* and thus asks the court to adjudicate the Exchange Act duty as part of the claim. In such cases, there is not just a "mere possibility" that the court will address the Exchange Act issue, as respondents repeatedly mischaracterize petitioners' position. There is instead every reason to presume that the state court will resolve the case as pleaded and adjudicate the duty. Section 27 exists to prevent that very outcome.

There is also a strong policy reason to interpret § 27 more broadly than § 1331, for claims that fall within § 27's narrow confines. Because § 27 was enacted specifically to keep certain cases in federal court, its language cannot be construed by reference to the traditional § 1331 jurisdictional principle that state courts are competent to resolve most federal questions, as respondents urge. Resp. Br. 48-49. Section 27's exclusive jurisdiction is founded on the *opposite* premise, *viz.*, that "state court judges" are *not* presumed competent to "say definitively what the Exchange Act means and enforce legal liabilities and duties thereunder." *Matsushita*, 516 U.S. at 383. Respondents observe that state courts do adju-

dicate various general securities-law issues, but the Exchange Act is unique among federal securities laws, addressing the particularly national interests inherent in the national trading markets' proper functioning. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 752 (1975); 15 U.S.C. § 78b (Exchange Act preamble). The fact that some state courts sometimes address fraud by individual issuers in particular securities transactions gives them no expertise in enforcing the reticulated duties the SEC has prescribed to regulate trading on national exchanges.

Finally, importing § 1331's federal-necessity rule into § 27 is not required to make § 27 jurisdiction "workable." Resp. Br. 50. Section 27's jurisdictional rule is already more administrable than the § 1331 multifactor test respondents would impress onto § 27. Under § 27, a court need only ask whether the complaint seeks to establish liability on the ground that the defendant breached an Exchange Act duty. By contrast, § 1331 requires a court to determine whether the federal issue is "(1) necessarily raised, (2) actually disputed, (3) substantial, and (4) capable of resolution in federal court without disrupting the federal-state balance approved by Congress." *Gunn v. Minton*, 133 S. Ct. 1059, 1065 (2013).

The difficulty of the latter inquiry is illustrated by the decisions below, both of which *agreed* that respondents' complaint sought to establish liability in part on the ground that petitioners allegedly violated Regulation SHO, *see infra* at 18, as required for jurisdiction under § 27's plain terms. Yet the courts came to opposite conclusions about § 1331 jurisdic-

tion. *Compare* Pet. App. 33a-34a *with* Pet. App. 13a-18a. Their disagreement was based only on the "necessity" requirement, i.e., whether liability could *possibly* be based on breach of a state-law duty, rather than on the breaches of Regulation SHO duties explicitly pleaded as a basis for liability. The court of appeals did not even reach the additional inquiries required under § 1331, including whether the issue was sufficiently "substantial," and whether jurisdiction would "disrupt[] the federal-state balance."

The fact that § 27 is easier to apply than § 1331 is not to say that jurisdictional inquiries under § 27 will always be devoid of controversy. Important legal rules rarely are. But § 27's straightforward rule is certainly *more* administrable than the § 1331 construct respondents would gloss onto § 27. And because § 27 does not implicate the policy concerns that led to that construct, the fact that § 27's language still might "entail[] some uncertainty" provides "no excuse for judicial amendment of the statute." *Knight v. CIR*, 552 U.S. 181, 194 (2008).

2. Respondents' reading of § 27 also cannot be reconciled with its central objective of keeping Exchange Act issues largely out of state court and thereby assuring "greater uniformity of construction and more effective and expert application of' the Exchange Act and its regulations. *Matsushita*, 516 U.S. at 383 (quotation omitted).

Respondents do not seriously contend that their interpretation of § 27 would advance Congress's objective of mitigating the "danger that state-court judges who are not fully expert in federal securities law will say definitively what the Exchange Act

means and enforce legal liabilities and duties thereunder." *Id.* Respondents instead invoke the truism that no statute seeks to achieve its purpose at all costs, and they observe that the well-pleaded complaint rule precludes absolute interpretive uniformity and expert application of the Exchange Act. Resp. Br. 41-43. But nobody contends that § 27 must create *complete* interpretive uniformity—its principal objective was to assure "*greater* uniformity" than § 1331 would allow. *Matsushita*, 516 U.S. at 383 (emphasis added). Applying § 27 by its plain terms would further that purpose, whereas respondents' atextual interpretation would authorize state courts to make definitive, precedential rulings on Exchange Act duties merely because those courts *might* issue dispositive rulings on state-law issues instead.

Consider the example the Third Circuit cited: a state-law RICO suit alleging both Exchange Act and state-law violations as predicate acts. Pet. App. 15a. Because such a suit expressly asks the court to interpret and enforce Exchange Act duties, it falls unambiguously within § 27's ambit. There is no basis in the text or purpose of § 27 for excluding such a suit merely because it *also* asks the court to find violations of independent state-created duties. Yet respondents' theory would require those suits to proceed in state court. Pet. App. 15a.

The example illustrates why § 27 does not exclude state-law claims that seek enforcement of the defendant's Exchange Act duties merely because it is *possible* that "no actual federal issue" will be "ultimately reached." Resp. Br. 49. For one thing, it is highly unlikely that when a complaint explicitly in-

vokes a federal duty as a basis for liability, a federal court would simply ignore the federal duty and focus solely on alternative state-law duties. But even that rare situation would hardly constitute a unique or troubling exercise of federal judicial power. Federal courts *routinely* resolve purely state-law issues when they exercise diversity jurisdiction. *See* 28 U.S.C. § 1332. And the federal-officer removal statute, 28 U.S.C. § 1442(a), requires only the existence of a federal *defense*. *Mesa v. California*, 489 U.S. 121, 136 (1989). That statute reflects a "congressional policy" that the federal interests involved "require the protection of a federal forum," *Kircher v. Putnam Funds Trust*, 547 U.S. 633, 644 n.12 (2006), even though the court might never reach any federal issue.

The same policy is embodied in the Exchange Act, which was enacted to "remove impediments to and perfect the mechanisms of a *national* market system for securities and a *national* system for the clearance and settlement of securities transactions," and to "protect," among other things, "interstate commerce, the national credit, the Federal taxing power." 15 U.S.C. § 78b (emphasis added). And the whole point of § 27 was to assure that this overriding *federal* interest would be protected by expert *federal* courts.

3. Respondents also cite a separate statute, § 22 of the Securities Act of 1933, to argue that Congress intended § 27 to operate as an ordinary "arising under" jurisdictional grant. But Securities Act § 22 only confirms the error in respondents' analysis of § 27.

Unlike § 27, Securities Act § 22 establishes concurrent jurisdiction in federal and state courts, but otherwise uses nearly identical jurisdictional lan-

guage. 15 U.S.C. § 77v(a). Also unlike § 27, § 22 includes a non-removal clause, which provides: "Except as provided in section 77p(c) of this title, no case arising under [the Securities Act] and brought in any State court of competent jurisdiction shall be removed to any court of the United States." 15 U.S.C. § 77v(a)). Respondents assume that "arising under" as used in that non-removal clause refers to the language of § 1331. They then reason that because § 22's jurisdictional grant cannot logically be broader than its non-removal clause, the jurisdictional grant cannot confer jurisdiction more broadly than § 1331. And because § 22's jurisdictional grant is identical to § 27's, respondents conclude that § 27 also cannot confer jurisdiction more broadly than § 1331. Resp. Br. 35-36.

Respondents' logic fails at its threshold premise: the phrase "arising under" as used in § 22's non-removal clause refers not to § 1331 jurisdiction, but to the full limits of Article III jurisdiction. This distinction is evident both from the legal backdrop against which § 22 was enacted, and from a subsequent amendment confirming the distinction.

a. At the time the Exchange Act was enacted, this Court's precedents established that the phrase "arising under" as used in *removal* provisions referred to Article III limits, not the more restricted limits of *statutory jurisdictional grants*. The first federal-question jurisdiction provision, enacted in 1875, both granted original jurisdiction over "all suits ... arising under" federal law and permitted parties to remove from state court any civil suit "arising under" federal law. 18 Stat. 470, 470-71.

This Court held that the 1875 law's "arising under" removal provision reached any case within Article III's broad scope, including any case in which a federal question "forms an ingredient of the original cause" even though it also "involves questions which do not at all depend on the Constitution or laws of the United States," and any case where the federal issue would be raised only by way of defense. *New Orleans, M. & T.R. Co. v. Mississippi*, 102 U.S. 135, 141 (1880); *see Union Pac. Ry. Co. v. Myers*, 115 U.S. 1, 13-14 (1885). In *Metcalf v. City of Watertown*, 128 U.S. 586 (1888), however, the Court held that the 1875 act's "arising under" jurisdictional grant did *not* invoke the limits of Article III, but included what is now labeled the "well-pleaded complaint rule" and thus was not triggered by the existence of a federal defense. *Id.* at 588-89. *Metcalf* distinguished *Mississippi* as a "removal case[]." *Id.* at 589.

In 1887, Congress amended the federal-question removal provision, superseding *Mississippi* and *Myers* by limiting removal to suits "arising under" federal law "of which the courts are given original jurisdiction by the preceding section." 24 Stat. 552, 553-54. This Court subsequently held that this new and narrower removal provision was coextensive with the narrower statutory "arising under" jurisdictional grant, but only because of the specific language Congress added in the 1887 Act. *See Tennessee v. Union & Planters' Bank*, 152 U.S. 454, 461-62 (1894).

The 1933 Congress thus would have recognized that the term "arising under" in the removal context invoked full Article III jurisdiction *unless* the term was limited by additional statutory language. By

omitting any such limitation from § 22's "arising under" non-removal provision, Congress invoked the limits of Article III jurisdiction and imposed the broadest possible bar to removal, thereby avoiding any disputes over removal of cases in which a Securities Act issue arose only as a defense or was only an "ingredient" of the pleaded claims.

b. A 1998 amendment to § 22's non-removal clause confirms that its reference to "arising under" invokes Article III jurisdiction rather than § 1331's statutory limits. That amendment added a proviso—which respondents' brief replaces with an ellipsis, Resp. Br. 36—excluding certain cases from the non-removal provision. The provision now reads: "*Except as provided in section 77p(c) of this title*, no case arising under" the Securities Act and filed in state court "shall be removed to any court of the United States." 15 U.S.C. § 77v(a) (emphasis added). The "except" proviso refers to cases that fall *outside* § 1331, but *within* Article III—they are "covered class action[s] based upon the *statutory or common law of any State* or subdivision thereof" that allege securities fraud, regardless whether the complaint alleges a Securities Act violation. 15 U.S.C. § 77p(b) (emphasis added); *see Kircher*, 547 U.S. at 642 (only cases falling within § 77p(b) are removable under § 77p(c)). Federal jurisdiction in such removed cases is predicated only on the federal preclusion *defense* created by § 77p(b). *See Kircher*, 547 U.S. at 642-44 & n.12. The "except" proviso thus confirms that—consistent with this Court's pre-1933 precedents construing "arising under" in the removal context—§ 22's non-removal clause invokes full Article III ju-

risdiction, rather than the narrower limits prescribed by § 1331.

c. In sum, read as a whole and in the context in which it was originally enacted, § 22's non-removal clause does not support, but undermines, respondent's contention that § 22's jurisdictional grant (and hence § 27's as well) must be read as coextensive with § 1331 "arising under" jurisdiction. The clause reflects Congress's recognition that a removal prohibition *broader* than § 1331 is necessary to bar removal of any case falling within § 22's jurisdictional grant. It follows that § 27's jurisdictional grant is likewise broader than § 1331, at least for the narrow category of cases the provision addresses.

C. Section 27's Plain Language Encompasses Respondents' Complaint

As both courts below recognized, respondents' complaint asserts violations of Regulation SHO duties and therefore triggers § 27 jurisdiction unless § 27 is limited to suits in which adjudication of an Exchange Act duty is *necessary* to resolution of the claim. Pet. App. 29a (district court) ("the alleged unlawful conduct is predicated on a violation of Regulation SHO"); *id.* at 9a (Third Circuit) (respondents "assert in their Amended Complaint, both expressly and by implication, that [petitioners] repeatedly violated federal law," i.e., Regulation SHO).[6] Respond-

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[6] Respondents cite the Third Circuit's statement that none of the claims in the complaint "are predicated *at all* on a violation of Regulation SHO," Pet. App. 14a, but that portion of the opinion was analyzing jurisdiction under § 1331 and its required "necessity" showing. Pet. App. 13a-15a. As the court explained in the next two sentences—omitted by respondents—

ents essentially agree—as they put it, their complaint does not trigger federal jurisdiction because they "do not *need* to prove anything about Regulation SHO to establish their state law claims." Resp. Br. 30 (emphasis added). And petitioners, they say, can establish jurisdiction only by showing "that at least one of Respondents' causes of action might somehow *require* a judicial determination that Regulation SHO had been violated." Resp. Br. 29 (emphasis added).

As already shown, however, necessity is relevant to § 1331, not to § 27. And leaving necessity aside, there is no doubt that § 27 is satisfied: respondents elected to allege that petitioners violated duties created by Regulation SHO as a basis for tort recovery under New Jersey law, even if they could *also* establish liability on independent state-law grounds.[7]

The complaint seeks to establish liability for conduct respondents describe interchangeably as "un-

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the New Jersey RICO claim did not explicitly identify a violation of Regulation SHO as a "predicate act," and the other state-law claims did not "*necessarily* need to be predicated on a violation of Regulation SHO for Plaintiffs to have a chance at recovering under state law." Pet. App. 15a (emphasis added). At the certiorari stage, respondents argued that that the same statement from the Third Circuit's opinion created an "antecedent fact question" about the complaint's allegations that made the case a "poor vehicle" for resolving § 27's meaning. Opp. 14. This Court implicitly rejected that contention in granting certiorari.

[7] Petitioners have always contended that the complaint satisfies § 1331. If § 1331's necessity requirement also applies to § 27, petitioners submit that the complaint still triggers jurisdiction.

lawful naked short selling" or "illegal short selling." Respondents allege that short selling is a "legal and accepted trading strategy," but only "[w]hen conducted in accordance with securities and other laws and regulations." Pet. App. 49a (Compl. ¶ 24). And "a critical requirement of a *lawful* short sale," the complaint alleges, is compliance with "securities laws and regulations [that] require a Short Seller to borrow the stock it sold and deliver that borrowed stock within three days of the short sale (the 'Settlement Date')," a "settlement cycle ... known as 'T+3.'" Pet. App. 49a-50a (Compl. ¶ 24).

The only securities law or regulation identified in the complaint as allegedly "requir[ing] a Short Seller to borrow the stock it sold and deliver that borrowed stock" is Regulation SHO. Pet. App. 51a-52a (Compl. ¶¶ 24, 28). According to the complaint, Regulation SHO was promulgated to establish "uniform 'Locate' and 'Close-Out' requirements and prevent unlawful naked short selling, in which market participants like the Defendants ... never intended to borrow or locate for delivery to buyers and close-out by settling their trades." Pet. App. 52a (Compl. ¶ 28). The complaint alleges that Regulation SHO requires a seller to "Locate" stock—i.e., identify shares to borrow—and deliver shares on the T+3 Settlement Date or immediately "Close-Out" the "fail to deliver." The complaint alleges that petitioners' decisions not to do so means they engaged in "unlawful naked short selling" that created an "unauthorized, fictitious and/or phantom share of stock." Pet. App. 44a, 51a-52a, 54a-56a (Compl. ¶¶ 4, 27-28, 31, 34-35); *see* Petr. Br. 9-10, 20-21. The only alleged

source of the duties to "Locate" and "Close-Out" is Regulation SHO itself—as the Third Circuit recognized, "there is no New Jersey analogue to Regulation SHO." Pet. App. 9a.

The complaint, in short, *defines* the "illegal short selling" that is the basis for liability as short selling in violation of Regulation SHO duties. The complaint then alleges that petitioners committed a pattern of this "illegal short selling," as illustrated by repeated alleged violations of Regulation SHO. Pet. App. 75a-81a (Compl. ¶ 81-85). Turning to respondents' claimed injuries, the complaint alleges that petitioners committed this same "illegal short selling" to create "counterfeit shares" of Escala stock and thereby dilute respondents' share values, Pet. App. 57a-75a, 81a-82a (Compl. ¶¶ 39-80, 86-87), including by giving and receiving "false 'Locates'" of Escala stock, Pet. App. 58a (Compl. ¶ 41). The complaint also cites the Regulation SHO "Threshold list" of "fail[s] to deliver" for Escala stock to establish that petitioners were committing "naked short selling" to "manipulate the pricing of Escala downward." Pet. App. 63a (Compl. ¶ 53). Finally, respondents' state-law causes of action assert as a basis for liability respondents' "illegal" or "unlawful" "naked short selling"—again, defined in the complaint as short selling that violates Regulation SHO duties—which allegedly injured respondents by creating "counterfeit shares" of Escala stock through failures to obtain a Regulation SHO Locate and to deliver by the Settlement Date. Pet. App. 85a-86a, 88a, 95a, 96a, 97a, 99a, 100a) (Compl. ¶¶ 98, 100, 105, 131, 137, 143, 152, 157).

Those allegations unambiguously seek to enforce Regulation SHO's Locate and Close-Out duties through state-law remedies. Pet. App. 101a. The alleged Regulation SHO violations are hardly mere "background" (Resp. Br. 30)—they are central to the liability respondents seek to establish. It is fantasy to suggest that the complaint's claims are "based exclusively on state law—in every respect." Resp. Br. 31 n.21. Respondents say that Regulation SHO is not mentioned "in *any* of the 73 paragraphs of the Amended Complaint setting forth Respondents' claims against Petitioners." Resp. Br. 30 (citing Pet. App. 82a-93a (Compl. ¶¶ 88-122)). But *the first paragraph* they cite incorporates every prior allegation by reference. Pet. App. 82a (Compl. ¶ 88). And the substantive claims that follow explicitly allege liability based on the "unlawful" or "illegal" "naked short selling" that is earlier *defined* as a violation of Regulation SHO duties. *See supra* at 21-22.

Even if a court adjudicating the complaint could theoretically ignore the alleged Regulation SHO duties that saturate the complaint and still find liability, breaches of those duties nevertheless are *alleged* as a basis for state-law liability, which suffices to trigger jurisdiction under § 27. And make no mistake, those allegations matter, even if there is a possibility that respondents might prevail in the absence of Regulation SHO, as respondents suggest. Resp. Br. 2. If respondents had not chosen to allege Regulation SHO duties, their case would look very different: the complaint could not assert violations of the Locate and Close-Out requirements, because no such requirements exist under any New Jersey

law or regulation, and respondents therefore could not base any claims on "illegal short selling" as they currently define it. Petitioners, in turn, would have a compelling motion to dismiss on the ground that the conduct alleged violates no duty prescribed by New Jersey law. As it is, however, the complaint respondents chose to plead is one that relies on Regulation SHO duties as a basis for state-law liability, which is why the complaint triggers § 27 jurisdiction.

CONCLUSION

The decision below should be reversed.

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November 23, 2015

STATUTORY APPENDIX

APPENDIX

Section 2 of the Securities Exchange Act of 1934 provides:

15 U.S.C. § 78b. Necessity for regulation

For the reasons hereinafter enumerated, transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are effected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto, including transactions by officers, directors, and principal security holders, to require appropriate reports to remove impediments to and perfect the mechanisms of a national market system for securities and a national system for the clearance and settlement of securities transactions and the safeguarding of securities and funds related thereto, and to impose requirements necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and Federal Reserve System, and to insure the maintenance of fair and honest markets in such transactions:

(1) Such transactions (a) are carried on in large volume by the public generally and in large part originate outside the States in which the exchanges and over-the-counter markets are located and/or are effected by means of the mails and instrumentalities of interstate commerce; (b) constitute an important part of the current of interstate commerce; (c) involve in large part the securities of issuers

engaged in interstate commerce; (d) involve the use of credit, directly affect the financing of trade, industry, and transportation in interstate commerce, and directly affect and influence the volume of interstate commerce; and affect the national credit.

(2) The prices established and offered in such transactions are generally disseminated and quoted throughout the United States and foreign countries and constitute a basis for determining and establishing the prices at which securities are bought and sold, the amount of certain taxes owing to the United States and to the several States by owners, buyers, and sellers of securities, and the value of collateral for bank loans.

(3) Frequently the prices of securities on such exchanges and markets are susceptible to manipulation and control, and the dissemination of such prices gives rise to excessive speculation, resulting in sudden and unreasonable fluctuations in the prices of securities which (a) cause alternately unreasonable expansion and unreasonable contraction of the volume of credit available for trade, transportation, and industry in interstate commerce, (b) hinder the proper appraisal of the value of securities and thus prevent a fair calculation of taxes owing to the United States and to the several States by owners, buyers, and sellers of securities, and (c) prevent the fair valuation of collateral for bank loans and/or obstruct the effective operation of the national banking system and Federal Reserve System.

(4) National emergencies, which produce widespread unemployment and the dislocation of

trade, transportation, and industry, and which burden interstate commerce and adversely affect the general welfare, are precipitated, intensified, and prolonged by manipulation and sudden and unreasonable fluctuations of security prices and by excessive speculation on such exchanges and markets, and to meet such emergencies the Federal Government is put to such great expense as to burden the national credit.

Section 27 of the Securities Exchange Act of 1934 provides in relevant part:

15 U.S.C. § 78aa. Jurisdiction of offenses and suits

(a) In general

The district courts of the United States * * * shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. * * *

* * *

Section 28 of the Securities Exchange Act of 1934, provides in relevant part:

15 U.S.C. § 78bb. Effect on existing law

* * *

(b) Rule of construction

Except as provided in subsection (f), the rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity.

* * *

Section 16 of the Securities Act of 1933, as amended by § 101(a) of the Securities Litigation Uniform Standards Act Of 1998, provides in relevant part:

15 U.S.C. § 77p. Additional remedies; limitation on remedies

* * *

(b) Class action limitations

No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging—

(1) an untrue statement or omission of a material fact in connection with the purchase or sale of a covered security; or

(2) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.

(c) Removal of covered class actions

Any covered class action brought in any State court involving a covered security, as set forth in subsection (b), shall be removable to the Federal district court for the district in which the action is pending, and shall be subject to subsection (b).

* * *

Section 22 of the Securities Act of 1933 provides in relevant part:

15 U.S.C. § 77v. Jurisdiction of offenses and suits

(a) Federal and State courts; venue; service of process; review; removal; costs

The district courts of the United States * * * shall have jurisdiction of offenses and violations under this subchapter and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, except as provided in section 77p of this title with respect to covered class actions, of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter. * * * Except as provided in section 77p(c) of this title, no case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States. * * *

* * *